THIRD EDITION

Eastern Economy Edition

A CONCISE HISTORY OF INDIAN ECONOMY

Dhires Bhattacharyya

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A CONCISE HISTORY OF INDIAN ECONOMY

From the Mid-Eighteenth Century to the Present Day

THIRD EDITION

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Preface

In the earlier editions of this text, the period chosen for study was the two hundred years from 1750 to 1950, and the book was intended to be a brief chronicle of the major economic changes that occurred in India under the impact of the British rule. Such changes became manifest in the country's land revenue system, tax structure, the agricultural-industrial balance, currency and coinage, transportation and communications and, of course, in the trade relations between India and the West. One can say that the general purpose of economic policy during those imperialistic years was to secure Great Britain's economic interests under the facade of schemes that pretended to uphold the interests of the impoverished Indians. Not that everything in the schemes was a pretence. There certainly were well-intentioned British administrators, conscious of the burden cast on them by Destiny. But the rules of the game were heavily loaded in favour of Britain, and except for a handful of calculating and subservient Indians, the rest of the native population derived little benefit from the imperialist regime. Our chronicle, therefore, ended on the note that the termination of the British connection in 1947 was sure to initiate changes that would redound to the benefit of the common people in India.

In the present edition, an attempt has been made to take stock of the most important developments on the economic front since the era of a 'planned (mixed) economy' was ushered in by the Government of independent India in 1951. The years between 1947 and 1951 were marked by the scars of the partition of the country that accompanied independence Beginning from 1951, a series of Five Year Plans were prepared and executed. and concomitant policy measures were formulated, all with the professed objective of realising the social and economic goals enshrined in the chapter on Directive Principles of State Policy in the Constitution of India. Since then, the growth performance of the economy has definitely improved. but to what extent the benefits of growth have percolated to the common people of India remains a matter of keen deba even today. No attempt has been made to go into such debates at all, since this book is no more than a chronicle of events and actions. However, in this edition, the story of India's economic ups and downs has been narrated for a longer period than before. In general, the end of the decade of 1970s has been taken as the terminal point in our story. Many more changes have come in over the last few years, but they are too recent to be incorporated in a book of this kind.

On particular aspects of the history being recorded here, there are many excellent books, some of which have been referred to in the Bibliography at the end of the book. The reader who has gone through text is strongly advised to consult these references if he wishes to fill in the blanks left by this deliberately abbreviated history. Our purpose is not to provide a detailed assessment of the changes that have been noted, but simply to give an introduction that can guide the reader through the maze of the vast, and somewhat disorganised, literature on Indian economic history.

I wish to thank Mr. J. Banerjee, who had worked under Sir Theodore Gregory at the London School of Economics in the early 1930s, for contributing two of his research papers on the currency history of India for inclusion in the book. These have been printed as Appendices B and C. Appendix A deals in some detail with the consequences of the 1947 partition on the Indian economy (as well as on Pakistan's). I am also grateful to Sri Kaushik Chattopadhyay who has rendered very useful service in the preparation of the Bibliography.

DHIRES BHATTACHARYYA

1
Prelude

I

In the middle years of the eighteenth century India was passing through one of those recurrent crises in Indian history when the decline of central authority tempted a number of contenders to vie with each other for political supremacy and thus invited administrative and economic disruption. It is true that in the Indian social structure the central administration has always remained more or less confined to a few urban areas. The villages carried on their usual round of activities without being considerably affected by the changes which might be occurring in the character of the central political authority. But the rapid changes that accompanied the break-up of the Mughal Empire created a certain amount of confusion even in the remotest areas. New agencies of pillage and plunder suddenly raised their heads. Traditional sources of authority were replaced by others less known and less rooted in public tradition. The land revenue, which happened for ages to be the major link between the villages and the ruling political power, came to be exacted by a number of unscrupulous adventurers. Cultivation shrank, people were forced to hoard and conceal their assets, and fortunes made in previous years from trade and moneylending were either snatched away or dissipated. These attitudes of hoarding, secretiveness and mistrust of the administrative authorities continued to be the dominant characteristics of the rural populace in India for a long time even after the conditions that called forth such attitudes eventually disappeared.

The land revenue administration of the Mughal Emperors itself tended to create a large number of more or less powerful intermediate local authorities positioned between the Central Government and the actual cultivator. Moreland classifies these intermediaries as Chiefs, Representatives, Assignees, Grantees and Revenue Farmers.[1] The Chiefs came from the ranks of Hindu Kings who, defeated by the Mughals in war, were left in control of large areas of land on the condition that they would pay tributes in cash to the Mughal Emperor. The Imperial Authority would leave the internal administration of such areas to the Chief and no direct administrative link would be maintained with the cultivators there. So long as the Chief punctually paid his tribute, he would be left free to deal with his subjects as he

1. Moreland, W.H., *The Agrarian System of Muslim India*. Cambridge, 1929, Ch. 1.

pleased. The consequence of default would perhaps be a punitive expedition by the local Governor against the defaulting Chief. On such occasions the Governor's regular troops would be reinforced, if necessary, by troops from the Imperial headquarters.

Representatives were headmen of villages who, acting on behalf of the local peasantry, accepted a certain liability for land revenue payment which they would then apportion among the peasants. Agreements on the amount to be so paid were usually entered into for a short period, sometimes for only one agricultural season, between the official assessor and the village headman. In arriving at the land revenue for which a particular village would be held liable, naturally the most important factor to be taken into account was the area sown or likely to be sown in the village during a particular season.

Assignees were civil or military officials of the State who, instead of being paid in cash, would be assigned either the whole or a part of the land revenue due to be collected from a specified area. To enable the Assignee to collect his dues he would be vested with a certain amount of penal power. In addition State help would normally be made available to him in case he failed to realise his dues by his own authority.

Grantees were similar to Assignees except that the grants of revenue made in their favour were generally rewards for meritorious work or learning. While the assignment was conditional on the Assignee's continuing to render satisfactory service, the grant was usually unconditional. But instances occurred when the grantee on incurring the Emperor's displeasure was deprived of his grant, just as the Assignee might be dispossessed for failing to render the service expected of him.

Revenue Farmers were either officials of the State or outsiders who by taking upon themselves the liability to pay a fixed annual sum to the State relieved the central executive authority of the trouble and expenses of collecting revenue from a large number of cultivators scattered over a wide area. In some cases the Governor of a province or some official under him might assume the role of a revenue farmer in addition to his normal administrative duties. In other cases, influential local people might be induced, by considerations of both monetary gain and prestige, to become revenue farmers, holding their office under the authority of the Imperial power. Quite frequently revenue farming would become a hereditary occupation, the son receiving the *sanad* (or grant of authority) from the Emperor automatically after the father's death.

The diverse arrangements for the collection of land revenue, described above, show that in Mughal India all authority over land and land revenue flowed from the Emperor. No individual rights of ownership could be claimed by any of the intermediaries, or for that matter even by the cultivators. In the centralised system of government which prevailed in those days the Emperor's will was supreme. He could make or unmake both

nobles and peasants. So long as his political power remained dominant, his authority in all economic matters also reigned supreme. The only recognised limit to his power in economic matters arose from the possibility that, with cultivable land still plenty and manpower scarce, severity of treatment might lead cultivators to abandon cultivation and excessive taxation of trade and industry might deprive the Royal Court of many of the luxuries which industry turned out and trade helped to procure from foreign countries.

This eminently practical limit was observed, in the matter of land revenue assessment, by the fixation, during the early Mughal period, of one-third of the gross produce from land as the share of the State. When the land revenue came to be collected in cash, it was therefore found necessary to fix different cash rates for different crops, the rate being usually stated as a certain amount of cash per unit of area. The basic rule of claiming about one-third of the produce for the State, respected as far as practicable up to the end of Akbar's reign, gradually lost its force Towards the end of the Mughal era almost one-half of the gross produce was being claimed by, or on behalf of, the State.[2]

By the seventeenth century the bulk of the land revenue of the country had come to be assigned to intermediaries of one type or another. These intermediaries were, however, hardly left in secure possession and enjoyment of their rights Their assignments were of short duration and depended essentially on the whim of the Emperor. No member of the nobility could hope to leave his fortune to his descendants, since the Emperor might exercise his right of escheat. Thus saving and accumulation were at a discount while hoarding and concealment of property became the order of the day. Moreover, as the political power of the Mughal emperor declined, his assignees also began to lose their grip on the countryside.[3] In South India the assignees had to share their revenues with the armed Maratha hordes who established their claim on the revenue by force. In North India members of the local nobility began to arm themselves by taking advantage of the weakness in the Central administration and drove away State officials and assignees from their territories. "The eighteenth century", says Moreland, "was thus a period when *de facto* possession came to count for much more than a title." The Chiefs re-asserted their rights on territories which they so long held by paying tribute to the Emperor. Local officials proclaimed themselves as independent kings. Towards the end of the eighteenth century, when the British East India Company attempted once again to establish its own centralised revenue administration, it had to contend against the claims of this motley crowd of adventurers many of whom

2. Moreland, *op. cit.*, p. 135.
3. Moreland, *op. cit.*, pp. 150ff.

might not have a valid or long-standing claim to the share of the revenue which they were found to administer.

II

The Indian village has from time immemorial consisted of three classes of people: the cultivators, village artisans and dependants. The crops raised by the cultivators have been used, after paying the State's revenue claims, to remunerate the village artisans for services rendered by them throughout the year and to support the needy according to traditional modes of charity, the residue being left for the cultivator and his family. The cultivators usually organised themselves into a village council, but in some cases spare land was allowed to be cultivated by persons not entitled to be members of the village council.[4] The latter were in effect tenants of the village council. They were called *paikast* ryots, while the rightful members of the village council were *khudkast*. The rights of the *paikast* group were nowhere clearly defined, but it seems that they were liable to ejectment at the end of each successive year. In practice, ejectment was rare in the condition of the times when land lay waiting for man and extension of cultivation was a universal object of desire.

The village council, referred to above, consisted of a group of cultivators who believed themselves to be in kinship and insisted on maintaining a separate identity aloof from other groups united by similar ties of kinship. The members of the group would cultivate their land separately, but would act together in managing the general affairs of the village, almost invariably through a Council of Elders. Within the village group there would, however, be various subdivisions on family lines. Discords among these subdivisions were not entirely uncommon. The village organisation performed its functions, but it could not and did not produce absolute harmony of interest among its members.

Each village generally had its Headman who would administer the general affairs of the village on behalf of the group, arrange for collection of dues towards charity and religious endowments, and, most important of all, haggle with the revenue assessors regarding the village's dues towards the State. There have been Headmen who have incurred the displeasure of the State by insisting too much on the rights of their co-villagers. On the other hand, there have been crafty Headmen who have deceived both fellow villagers and the State by realising a larger amount from the former while bargaining for a smaller amount with the latter. During the period of disintegration of the Mughal Empire some of these Village Headmen could, in favourable circumstances, establish their authority over their co-villagers and proclaim themselves as hereditary chiefs.

4. Moreland, *op. cit.*, p. 161.

III

Urban industry mainly catered to the needs of the Emperor and members of the Imperial Court. A certain portion of luxury production was exported. It was customary for the Royal Court to organise its own palace-workshops, called *Karkhanas*, so that an absolute control over supplies could be maintained. Bernier, the French physician who visited India in the middle of the seventeenth century, saw inside the Emperor's fortress "large halls...or workshops for the artisans. In one hall embroiderers (were) busily employed, superintended by a master. In another...goldsmiths; in a third painters; in a fourth varnishers in lacquer work; in a fifth joiners, turners, tailors, shoemakers; in a sixth, manufacturers of silk, brocade and fine muslins." The artisans would work in their respective workshops from early morning till evening and receive as their remuneration a fixed amount per day. They were treated rather harshly by their superintendents (*daroghas*) and their remuneration was generally small. The aristocracy of the Mughal empire wanted to have their luxuries at a favourable price and did not hesitate to use powerful pressure on the poor artisans. In this environment the artisan could hardly be expected to develop his skill in new directions. Yet, under suitable patronage, art and industry flourished on a scale which was the envy of many travellers from Europe and the Far East.[5]

Apart from these State factories there were also skilled artisans working on their own material and selling their wares in the outside market. The market for luxury goods was, however, extremely narrow and unless an artisan received the support of the Emperor or some local Chief he could hardly eke out his living. In fact, prosperity was confined to such a small section of the people that industrial growth remained too dependent on the fortunes of the Royal Court. Decline of royal power inevitably spelled ruin for almost all classes of artisans in the cities.

There was, however, a different type of industry in a number of towns and cities invested with religious sanctity. Places like Banaras, Puri or Tanjore have attracted pilgrims from all parts of India and they have patronised the specialised wares produced in these temple cities. Artisans turning out clothes to be worn on religious occasions or utensils to be used in religious functions have generally been able to enjoy an unbroken patronage in spite of the decline of royal power and the withdrawal of royal favours.

The internal trade in industrial products remained limited due to the undeveloped nature of road communications, although trade in certain staples, such as sugar and salt, was carried on by using navigable rivers for their transport. Exchange of products between different parts of the country, specially on private account, was further hampered by the imposition of a number of internal transit duties. Towards the middle of the eighteenth

5. Sarkar, Jadunath, *Mughal Administration*, Ch. X.

century insecurity of travelling had greatly increased and the free movement of goods was possibly being further hampered by an increase in the number of toll-houses established by local rulers.

The English, French, Danish, Dutch and Portuguese traders who had started using India as a trading base during the sixteenth and seventeenth centuries suffered from this insecurity as much as any other traders. Their primary concern at this time was to safeguard their trading settlements against the prevailing insecurity and to maintain the profits of their respective Companies. The English East India Company had, in 1698, acquired possession of some land in and around Calcutta. It was in connection with building up the defences of their factory in Calcutta that the East India Company came into conflict with the then Nawab of Bengal, Siraj-ud-Dowlah.[6] The story of British ascendancy in India begins with the battle of Plassey (1757) which the British won under the leadership of Robert Clive. Their victory in this important battle gave the British the *de facto* right of installing in Bengal a Nawab of their own choice and subsequently of carving out for themselves a position of importance at the Imperial Court in Delhi.

In Southern India also, at about the same time, the British traders actively participated in disputes emerging within ruling dynasties over claims to succession. Very often the intervention of the foreign traders in such disputes was simply an outcome of their trading rivalries. Sometimes they would carry into India the political quarrels that their masters might be engaged within their home bases in Europe. The superior fire-power and discipline of troops recruited by European (specially British and French) trading companies also tempted quite a few short-sighted native rulers to seek their help in asserting their own rights in a dynastic dispute. As the number of such ambitious power-grabbers multiplied with the decline of Mughal power, the scope for foreign intervention in Indian affairs also increased. In a series of wars fought in modern Karnataka and Maharashtra the British East India Company established its claim to impose its dispensation on the Deccan Peninsula of India, although native rulers were permitted to remain in possession of their titles. As British political authority extended, its power to uproot traditional economic arrangements and institutions also gradually became more formidable. A new era, brighter in some respects and darker in many, had now definitely dawned upon the people of India.

6. There were also other causes of quarrel between the Nawab and the English Company. The tendency on the part of English officials to engage in unauthorised trade, the conspiratorial nature of the Company's agents, parleys with the Nawab's dynastic rivals and the insolence perpetrated by the Company by giving shelter in Calcutta to persons who had incurred the Nawab's displeasure were also responsible for the showdown that led to the war at Plassey. See, *e.g.*, Ram Gopal *How the British Occupied Bengal*, pp. 72ff.

2

Trade under the East India Company

The British East India Company, incorporated under a Royal Charter in 1600, enjoyed a monopoly of British trade with India and the Far East until 1813. It was able to secure a number of trading privileges from the Emperor of Delhi and other local rulers in India. Conflicts arose because the privileges, granted in good faith, were often abused by the officials of the Company. Although in theory the Company, as a body corporate, had a monopoly of the Indian trade, its officials did not shrink from trading on their own account whenever an opportunity for profitable trade presented itself. At the same time the Portuguese, the Dutch, the Danes and the French were also engaged in trading with India. The chief articles of trade in this period were cotton and silk textiles, opium, and saltpetre. While the British and the French traded mostly in cotton and silk, the Dutch appear to have specialised in the opium trade with the Far East. In the middle of the eighteenth century the volume of British 'official' trade with India (that is, excluding trade illegally carried on by private British traders) exceeded Rs. 30 lakhs per annum.

The East India Company of British merchants obtained from the Emperor of Delhi in 1717 the right of exemption from all duties in respect of their authorised trade[1] on payment of Rs. 3,000 per annum to the Imperial Court. Taking advantage of the privileges conferred by this Imperial Order the Company's servants began to defraud the Exchequer of even its legitimate dues. Very soon this brought the Company into open conflict with the local administration in Bengal. After 1755 there was a rapid deterioration in the relations between the British East India Company and the Nawab of Bengal. Siraj-ud-Dowlah, the last independent Nawab of Bengal, charged the Company with defrauding the State of nearly Rs. 1½ crores by engaging in trade without payment of the usual duties on such trade.

Bengal's prosperity depended in that period largely on her external trade. Although she had to obtain some raw cotton from Central India and Gujarat, her manufactures enjoyed such reputation in the rest of India and in overseas markets that a large amount of bullion used to be imported

1. As the Emperor's *firman* was vaguely worded, controversy eventually arose as to whether free trading privileges related only to articles entering the Company's sea-borne trade or whether they extended to internal trade as well.

every year into Bengal in payment of her manufactured goods. The demand for Bengal's exportable luxury products did not decline even in 1750 because, although the splendour of the Mughal Empire had diminished after the invasions of Nadir Shah, the local Chiefs who were setting up independent courts in different parts of India maintained for some time the style of Imperial living. After the battle of Plassey, however, a great change occurred in the character of demand for Bengal's products. The domestic market for special types of luxury products shrank rapidly and Bengal's industry came to depend very largely on the custom made available to her artisans by the European (now mainly British) trading companies.

The most important of Bengal's industries in the eighteenth century was cotton weaving. Almost every district in Bengal had its distinct variety of cotton piecegoods. The weaver's establishment usually consisted of six or seven people. Spinning was carried on in almost every rural home. There were important centres of trade in cotton products all over the province. Trade appears to have been carried on without the help of an army of middlemen and under predominantly competitive conditions.

Silkworm rearing and the spinning and weaving of silk also provided important occupations for the people. Bengal had a number of well-known silk-producing centres. Their reputation spread to many parts of Europe as the European trading companies exported Bengal's silk wares to Europe. Saltpetre and opium were exported mainly from modern Bihar and Uttar Pradesh. After their victory at Plassey the British East India Company had no difficulty in obtaining from Mir Jafar, the new Nawab of Bengal installed by them, an exclusive right over saltpetre-bearing lands in Bihar.

The victory at Plassey also led the British East India Company to flout the local administrative rules regarding the conduct of internal trade. The officials of the Company now engaged openly, in defiance of the Nawab's officials, in types of trade to which they were not entitled and claimed privileges and exemptions which had never been granted them. There were also instances of predatory behaviour by some Company officials who refused to be controlled even by their superiors. What is worse, seeing the British traders thus taking advantage of their newly-won power, even native traders began to work for the British and thus carry on duty-free trade. One contemporary estimate puts it that the loss in revenue to the Bengal Exchequer due to this cause amounted to nearly Rs. 25 lakhs per year. There were cases of disturbances of peace as the Britishers' arrogance came to meet the resistance of native traders (who were undersold by British traders) as well as of native collectors of taxes. Mir Kasim, who became Nawab of Bengal in 1760, repeatedly brought these cases of misuse of power by English officials to the notice of the Company's Governor in Calcutta, but no redress was received in spite of promises frequently made to punish guilty officials. In 1762 the Company adopted some regulations to govern the

conduct of English officials by which the Company agreed that officials engaging in internal trade were to pay the usual duty of 9 per cent[2] on the cost of traded articles. But Vansittart, who thus took the initiative in easing the strained relation between the Company and the Nawab, himself became a target of attack as the Company's officials accused him of sacrificing their 'legitimate' rights. The regulations thus became a dead letter almost from the beginning. The Nawab tried to assert his authority by directing his administrative officials to suppress by force all disputes that might break out between the British traders and the Nawab's officials. He followed this up by announcing that all traders, foreign or native, would enjoy equally the privileges of duty-free trade for two years. By this means he tried to equalise the conditions of competition between the British and native traders as well as to eliminate the root cause of the conflicts that were frequently occurring in the countryside. The British officials would not take this challenge of the Nawab lying down. They argued that the right of making internal trade duty-free lay, not with the Nawab, but with the Emperor in Delhi. The more vocal section urged the Company to disown the Nawab's authority and replace him by a more docile ruler. In 1764 Mir Kasim was finally routed by the English in the battle of Buxar. Mir Jafar, re-installed as the Nawab of Bengal, agreed to grant to the Company all the trading privileges they were seeking. The effect of all these conflicts was to leave Bengal's trade at the mercy of over-bearing foreign traders and their native agents who, now freed from all restraints, began to accumulate huge profits at the expense of the native traders and artisans.

The private trading activities of the Company's officials were, however, adversely affecting the Company's administrative functions which were day by day becoming larger as the Company was coming to assume greater powers in relation to revenue and judicial administration in Eastern India. Emperor Shah Alam's grant of the *Diwani* of Bengal to the East India Company in 1765 not only increased the Company's prestige in this part of India, but was also a great financial boon. It enabled the company to dispense with the system of importing gold and silver bullion from Britain to purchase from Bengal the commodities that it wanted to export. The acquisition of the *Diwani* permitted the Company to use the land revenues of Bengal, Bihar and Orissa for 'investment' in exportable goods. In fact, bullion even began to be exported from Bengal to pay for the Company's purchases in China and elsewhere. At the same time the responsibilities of revenue administration were pressing hard on the company. The officials of the Company were required to give more of their attention to revenue affairs. Private trade by the Company's officials in Bengal was restrained to some extent in the years after 1765. But in other parts of India

2. See Dutt, R.C., *Economic History of India, 1757-1837*, p. 20.

passing into the Company's sphere of influence (*e.g.*, Oudh) fresh opportunities for private trade began to open up.

By 1767 the value of the Company's 'investment' had reached nearly Rs. 60 lakhs. Ten years later it rose to Rs. 1 crore. Almost nine-tenths of the Company's export trade consisted of cotton piecegoods and raw silk. With the establishment of a Board of Trade with eleven members in 1774, the Company established greater centralised control over its local purchases. But this did not completely eliminate the opportunities open to the Company's officials to engage in trading on their own account, depriving the Company of some chances of earning profits. The loopholes in the existing system of the Company's trade were plugged to a greater extent during the regime of Lord Cornwallis who introduced the practice of appointing paid commission agents to effect purchases on the Company's behalf. The competition from unauthorised private traders, however, grew in course of time as more and more British enterprise turned to reap the profits of Indian commerce. These "Free Merchants", as they were called, often used the ships of non-British trading companies to ply their trade with Europe. Their transactions were mainly confined to two commodities, *viz.*, indigo and opium.

Dutch and French competition in foreign commerce gradually became feeble after 1780. The American War of Independence led to the withdrawal of Dutch competition for a period. When the Dutch returned after the war to take up their trade activities they found the British Company entrenched in its position. The French withdrew after the outbreak of the French Revolution. The Danes were too weak to fill in the position left vacant by the Dutch and the French. Thus, the British East India Company became virtual monopolists in India's foreign trade, though some amount of native trade still persisted.

As the powers of the Company increased, its rules of business also became more stringent so far as deliveries of goods to its agents were concerned. The general system was to make advance payments (*dadan*) to weavers and other artisans for delivery of a stipulated amount of goods. Any one accepting such an advance payment could be prosecuted for non-delivery of goods and his stock confiscated. The compulsion to fulfil delivery schedules led many an artisan to abandon previous standards of craftsmanship. The emphasis shifted from quality to quantity. The weavers in particular had by this time been reduced to abject dependence on the Company's purchases of cotton piecegoods which, in the closing years of the eighteenth century, amounted to nearly Rs. 67–68 lakhs.

The Company faced little difficulty in marketing its exports of cotton piecegoods in Europe. But its exports of raw silk were not always saleable at a profit because of the relatively poor quality of the material.[3] The

3. Earlier, in 1769, the Company itself had decided in favour of raw silk exports from Bengal rather than manufactured silk goods.

Company, therefore, secured the services of a few Italian experts to improve the quality of Bengal's raw silk. On an average the Company purchased nearly Rs. 25 lakhs worth of raw silk every year from Bengal.

From about 1780 onwards, the East India Company's export trade in Indian industrial products came in for bitter criticism from the rising industrial interests in England. In 1782 the calico printers in England raised objection to the import of printed clothing from Bengal and succeeded in getting such imports stopped for four years in the first instance. The Manchester mills eventually succeeded in manufacturing fabrics as fine as the well-known Dacca Muslin at a cost nearly 20 per cent cheaper than the Indian price. Within about thirty years the Company's purchases of muslin from Bengal totally ceased. Cotton yarn as an article of India's export trade altogether lost its ground after 1785. In the closing years of the eighteenth century, prohibitive tariffs came to be imposed in Britain on Indian cotton manufacturers to encourage the growth of the cotton mill industry in Britain. The enhancement of inland transit duties in 1810 further injured the domestic industry and created conditions favourable for the sale of British manufactures in India. The net contraction of sales of Indian cloth manufactures between 1813 and 1833 has been estimated at Rs. 1.80 crores.[4] The paralysing influence of the inland customs and the British tariffs on the Indian cotton manufacturing industry is, however, hard to disentangle from the general disability from which the Indian weaving industry suffered in relation to the mechanised methods of cotton spinning and weaving then rapidly expanding in England.

The East India Company, always on the defensive against the vocal industrial interests of Great Britain, had little long-run interest in India's industrial future. Anxious only to safeguard somehow its commercial profits, the Company tried a number of measures to introduce articles other than cotton goods in its home-bound cargo. Articles like raw cotton, sugar, indigo, flax and jute received the Company's attention at this stage. The British demand for raw silk increased after 1807 due to Napoleon's blockade of exports of raw silk from the European mainland (mainly, Italy) to England, and for some years increased raw silk exports compensated to some extent for the declining exports of cotton piecegoods. Indian silk, however, was subject to a heavy import duty in England; the Company's trade arose largely from the demand for printed Indian silk goods in France and other European countries. The printing was often done by workers in England on imported silk goods from India.

Exports of sugar by the Company gave an impetus to sugarcane cultivation in the early years of the nineteenth century. After a period of falling

4. Trevelyan, C., *Report upon the Inland Customs and Town Duties of the Bengal Presidency* (1835).

exports during the Napoleonic Wars, Indian sugar recovered its market in Europe. But subsequently competition from the West Indies sugar plantations virtually eliminated Indian exports of sugar to the countries of Europe and Africa.

Indigo acquired a great importance as an article of export as cloth exports declined in the early years of the nineteenth century. Between 1800 and 1830 exports of indigo from the Calcutta port increased almost three-fold. Indigo could be produced cheaply in the delta regions of lower Bengal and in Bihar. There was a huge profit to be reaped from the cultivation of indigo as its European price was rising fast during that period. The indigo planters in Bengal and Bihar, in order to make their profits doubly sure, entered into rigid contracts with the cultivators of the crop, forcing them to plant indigo in preference to other crops but offering them little inducement in return. The relation between the owners of indigo factories and the cultivators of indigo became extremely strained as a result.

Opium, grown in Bihar, was exported almost exclusively to China. The sales of opium expanded more than three times between 1800 and 1834–35. In both the indigo and the opium trade private traders played a relatively prominent part, while the trade in such staples as cotton, silk or sugar was almost exclusively in the hands of the Company.

In the early years of its Indian trade the East India Company generally utilised the services of Indian agents and middlemen who were called *banians*. The officials of the Company as well as foreign private traders relied on these native agents for market information as well as for a part of their trading capital. But towards the end of the eighteenth century an important change began to occur in the organisation of foreign trade. Many of the ex-traders now set up themselves as Agency Houses in Calcutta and Bombay and offered their expertise as well as financial services, if required, to other merchants engaging in either internal or foreign trade. These Agency Houses secured capital for their business from the Company's officials who, now unable to engage in trade on their own account, entrusted their savings with the Agency Houses for a consideration. The Agency Houses played an important part in financing indigo and sugar factories, controlled the shipping trade, set up banks and insurance agencies and entered into the bidding for government contracts. They also invested in Government securities both on their own account and on behalf of their clients. They had occasionally to borrow funds from the Indian money-lenders and traders and could count on the Company's support when they needed it. Some Agency Houses occasionally came to grief by making unsuitable loans. But generally they were prosperous until all of them were shaken to the foundations by the disastrous fall in the price of indigo in the late 1820s. The Company's Government sought to retrieve the position of the Agency Houses by various methods, including measures to compel the cultivators of indigo to part with their crops even on unfavourable

terms. But with indigo prices falling continuously none of these devices succeeded in checking the total ruin of the Agency Houses.

Towards the end of the eighteenth century a new trade rival to the East India Company appeared on the scene. The first ever American ship to touch Calcutta came there in 1785. By 1797 American trade with India had become so considerable that British merchants, for ever critical of the Company's monopoly of the Indian trade, now began to cite the American intrusion into the Indian market as an argument in favour of ending the Company's trading monopoly. There was considerable demand for medium quality Indian cotton goods in the American market. But the Anglo-American War of 1811-12 checked the further development of American commercial relations with India. After the Charter Act of 1813 British private traders were able to enter the Indian trade in larger numbers. British freight rates were reduced and preferential treatment came to be accorded to British shipping at the Indian ports. Direct trade between America and India gradually dwindled into insignificance. The American market was also protected against Indian goods by the imposition of high import duties on cotton piecegoods from India. In the markets of the West Indies, served by American traders, cheaper British cotton piece-goods replaced those imported from Bengal.

In the middle of the 18th century about 50 to 60 ships used to come to Bengal yearly to carry the export cargo. By the end of the century the number of ships coming to Calcutta from Europe had risen to 300. After 1813, when private traders were allowed to operate in the Indian trade without any restriction, the volume of trade increased further. But the character of exports changed. Exports of cotton manufactures and sugar fell rapidly in the early years of the nineteenth century, while foodstuffs and industrial raw materials came to occupy a more prominent place in Indian exports. Imports largely consisted of Lancashire textiles, metals and mineral oils.

After the British victory at Plassey there developed a tremendous pressure for transfer of funds to Europe by Europeans in Bengal. The funds obtained by way of plunder or illegal gratification or from the profits of private trade were remitted to Europe by purchasing bills drawn by exporters in India or by sending out bullion and precious stones. The favourable balance of trade which emerged after 1770 was thus simply the counterpart of the pressure for remittance of funds. An estimate by the late Dr. J.C. Sinha put the outflow of resources from Bengal between 1757 and 1780 at nearly £38 million.[5] By the third decade of the nineteenth century not

5. Sinha, J.C., *Economic Annals of Bengal*, pp. 51-52.

Dr. Sinha's estimate was made up as follows: East India Company's remittances to England between 1757 and 1765, £2 million; Company's profits on exports and from sale of bills on England, £10 million: Exports of silver to China on Company's account between 1757 and 1780, £2.4 million; and purchases of bills by traders on non-British companies for the sake of remittances to England, £2 million. Total: £38.4 million.

only had the exports of traditional manufactures been virtually wiped out and imports of foreign-made goods increased; what is worse, funds for the development of new forms of manufacturing enterprise, made possible by the burgeoning technology of this period, had been drained off to England where industry and commerce were now flourishing as never before.

3

The Economic 'Drain' from India

The transfer of resources from India to England and other countries of Western Europe which began in the middle of the eighteenth century has been described by many economists as a 'drain' on Indian resources. Attempts have been made from time to time to measure the extent and assess the effects of this drain. The most notable attempt in this regard was made by Dadabhai Naoroji in 1871 in his study entitled 'Poverty and Un-British Rule in India', where he not only tried to quantify the magnitude of the 'drain' but also sought to prove that mass poverty in India was a direct consequence of the drain. It was in this connection that Dadabhai was led to draw up the first estimate of India's national product.

Unlike those parts of the British Empire, like Australia or Canada, which had been settled by emigrants from England, India did not receive any large influx of foreign enterprise or foreign capital. It is true that after 1813 restrictions on the settlement of Englishmen in India had been considerably relaxed, but by that time the direction of British migration had taken a different course. Thus India was left to develop her own resources largely through her own export earnings, while a substantial part of her accumulated capital funds found its way to Britain by way of tributes, plunder, profits from unauthorised trade and at a later period as interest on loans incurred by the British Government in India for the very purpose of extending British dominions in this country. The civil servants and military officials sent out from Britain enjoyed a salary scale, specially after 1787–88, which was too high in relation to average Indian incomes and remitted most of their savings to the mother country. For all these reasons the inflow of bullion from Europe to India dwindled after the middle of the eighteenth century. By 1770 India, with her favourable balance of trade over a succession of years, was beginning to fit the classical economists' description of a chronically indebted country.

As the East India Company came into the possession of India's territorial revenues, these could be used for making purchases of exportable items in India and elsewhere. Thus "profit-making through trade became integrated with administration which also became an instrument of profit-making".[1] The 'drain' mostly took the form of an unrequited export of goods, not an export of bullion. The 'surplus' of India's production was

1. Ganguli, B.N., *Dadabhai Naoroji and the 'Drain' Theory.*

skimmed off as a tribute to the newly acquired political power of the East India Company. There were also other calls for remittance of funds from India—from private traders engaging in inland trade, from civil servants making their fortune of a life-time and from top officials of the Company who were not above illegal gratification. All this demand for remittances could be met in an ordinary year by drawing bills on the trading companies and did not generally call for an export of bullion from India. In the absence of reliable data it is not possible to say to what extent remittance items figured in India's balance of payments at that time. The drain on the East India Company's account has been estimated at £3 million per annum, but the drain of resources on account of the private remittances remains to be estimated. Dadabhai himself believed that in the forty-year period between 1788–89 and 1828–29 the amount of resources transferred to Britain from India was no less than £1,500 million.[2]

In the 50-year period before 1757 the British East India Company appears to have imported goods worth about £6.8 million and English coins worth about £20 million. After 1757 the inflow of bullion fell off. There were periods, for example between 1777 and 1787, when there was, in fact, a substantial outflow of bullion from India to finance the Company's 'investments' in China. Outflow of bullion continued off and on until the opening years of the nineteenth century.

Between 1801 and 1863 there was, according to Dadabhai, a net influx of bullion into India amounting to £234.35 million, but this was relatively a small amount compared to India's tremendous export surpluses during this period. After 1864 the inflow of bullion was accelerated by the huge export surpluses India enjoyed for some years owing to the American Civil War. At about the same time British money was also flowing into India in the form of Railway loans. But the bullion imported throughout this period did not, contrary to popular European opinion, go to swell Indian gold and silver hoards. Gross coinage expanded between 1801 and 1869 by over £266 million. The import of bullion could not be regarded as a symptom of capital accumulation in India. On the contrary, the drain went on unhindered impoverishing the country and enriching England at India's expense.

As conceived by Dadabhai, the economic drain from India arose out of the following items:[3]

(*a*) remittances to England by European employees for the support of families and education of children—a feature of the colonial system of administration;

2. This is broadly of the same order as William Digby's estimate that the drain from British India between 1757 and the battle of Waterloo would be somewhere between £500 and £1,000 million. See Digby, W., *Prosperous British India*, 1902.

3. Ganguli, B N., *op. cit.*

(*b*) remittance of savings by employees of the Company, since most employees preferred to invest at home;

(*c*) remittances for the purchase of British goods for the consumption of British employees, as well as the purchase by them of British goods in India;

(*d*) government purchase of stores manufactured in Britain; and

(*e*) interest charges on public debt held in Britain (excluding interest payments on railway loans and other debts which might have been incurred for productive works). The net surplus on current account usually co-existed with some net inflow on the capital account. After 1801 India was importing silver bullion not only in payment for her trade surplus but also to supply the domestic demand for a convenient means of payment. In later years import of capital for the railways, irrigation works and other capital development projects took the form not only of imports of capital goods, but also resulted in some inflow of silver. Such capital imports, therefore, helped in maintaining the balance of payments in equilibrium whenever the current account surplus tended to fall short of the aggregate unilateral transfer from India which was described as the 'drain'. But Dadabhai did not let his analysis stop at this point. He traced the source of the capital inflow into India to the 'drain' of resources itself. It was the unilateral outflow from India that re-appeared as a capital inflow; the inflow did not represent any genuine transfer of resources from England to India. In fact, the capital inflow added to the burden of the so-called 'home charges' in subsequent years and indirectly produced the consequence of draining out more resources from India. All the above remittances were basically responsible for the surplus of exports in India's external trade. Between 1814 and 1865 the aggregate export surplus, as computed by Dadabhai, amounted to £350 million.

India's continuous export surplus was in sharp contrast with the import surplus which colonies like Australia or Canada ran with Britain. Australia, for example, imported during 1856–67 goods and bullion worth £309 million and exported goods valued at £268 million. Canada's exports and imports during the same period were respectively £120 million and £148 million. Heavy imports of British capital into these colonies generated employment and income, while India's meagre stock of capital was being drained away in the form of unrequited exports, depriving Indian agriculture and industry of much-needed imports of equipments. During the period 1856–67 India's exports, including treasure, amounted to £456 million, while her imports were estimated at £419 million. These imports included the value of railway equipments obtained by way of loan from Britain, the value of such loan being £72 million. Dadabhai recognised of course that Indian railways had been constructed with British capital, but the benefits produced by the railways were not very clear in the early years when the government was being called upon to make good

the losses of the railways from its tax revenues. As L.H. Jenks pointed out, the railways in India did not give rise to a flood of satellite innovations and probably destroyed more employment opportunities than they opened up.[4] Whatever foreign loans India had incurred till that period created only the vicious circle of repayments and more foreign borrowing for balance of payments reasons. Foreign borrowing had hardly promoted any domestic development such as had been experienced in other British colonies.

According to Dadabhai, the external drain described above had its counterpart in an internal drain—the transfer of purchasing power through taxation from the poverty-stricken rural masses to the richer urban centres. The transferred amount, barring a certain leakage by way of affluent consumption in the urban areas, formed the unrequited exports which made up the external drain. Since the transfer of Indian administration from the East India Company to the British Crown, Dadabhai pointed out, public expenditure had increased from £32 million (in 1856) to £49 million (in 1870–71). A substantial part of this increased expenditure was being met by increasing the tax on salt—a highly regressive form of taxation. One of Dadabhai's calculations showed that nearly 75 per cent of the tax revenues of the Government of India was derived from sources that impinged on the poor masses of the country. On the public expenditure side, while only 15 per cent was spent on welfare services for the people, the costs of defence and the maintenance of internal order accounted for nearly 60 per cent of the government's total expenditure.

Dadabhai was sharply critical of the existing public debt policy of the Government of India. Much of the public debt was frankly 'political' in character, being the result of the wars waged by Britain for the annexation of different parts of the Indian Empire. The amount of such political debts was roughly estimated at £100 million. Another source of iniquity was the practice of charging the entire expenditure of the India Office to the Indian budget. By way of contrast it was pointed out that the expenditure of the Colonial Office was debited to the United Kingdom and not to the colonies.

With the increase in public debt interest charges were also on the increase. Taxation imposed to meet this burden was highly regressive. The average tax burden in India, according to Dadabhai, was 14.3 per cent of income (in 1886) while in a much more prosperous country, England, the burden amounted to only 6.92 per cent of income. The tax system was made more oppressive by the fact that little was returned to the tax payer in the form of government services and welfare activities.

The 'drain', as conceived in Dadabhai's writings, was taking place not only in the form of commodities or capital. There was also an imperceptible drainage of human skill since industries were being killed one

4. Jenks, L.H., article in *Journal of Economic History*, 1944.

after another by unimpeded foreign competition and people were being forced to fall back on a primitive system of agriculture. The British connection had given to India nothing but a one-sided flow of resources from India to England: that was the sum and substance of Dadabhai's teaching. To anyone pointing out what the British had done for opening up new opportunities for Indian agriculture, Dadabhai would simply reply that the agricultural exports were only the vehicle through which resources flowed out from India. Another achievement of British rule often pointed out was the construction of the railways. But Dadabhai was not prepared to concede that the railways had conferred any substantial benefit on the Indian people. On the contrary they had increased the country's external obligations and to that extent were responsible for adding to the size of the 'drain'. In fact, most Indian public men of the nineteenth century looked upon the 'drain' of resources as imparting a mortal blow to the prospects of long-period development of the economy. Not only were valuable material resources transferred away to England, but the shock to the economy caused by such transfer also checked the growth of commercial and industrial enterprise, damaged the inclination to save and invest, and encouraged the tendency to build up idle hoards. All this implied that traditional techniques of production got a longer lease of life in the country. England's march forward to a new era of industrial development would certainly have been slower if it was not sustained by the 'bleeding' of India in the form of resources transferred without adequate recompense for the sacrifice.

4

Revenue Administration under the East India Company

After the British victory over the Nawab of Bengal in 1757 the entire inland revenue system of the Nawab was disrupted by the widespread practice of East India Company's officials and their Indian agents to carry on trade without paying the prevailing internal transit duties. They also played a significant part in distorting the domestic manufacturing system by arbitrarily laying down quotas and qualities of production and imposing a sort of bond-slavery on skilled artisans, specially, weavers. Uncertain and excessive exactions also adversely affected the agricultural classes.[1]

An agreement between the then Nawab of Bengal, Mir Kasim, and the local agents of the East India Company in 1762 to set a limit to the licentious behaviour of the Company's officials was set aside almost as soon as it was entered into. The Nawab reacted to this somewhat impulsively by abolishing all internal transit duties for both native and foreign traders. The result was a series of wars between the Nawab and the Company's troops in which the Nawab was defeated. He was deposed in July 1763.

In 1765 the East India Company again issued orders to stop the unauthorised internal trade carried on by their officials. That very year the Company received from the Mughal Emperor of Delhi a *firman* making them the *Diwans* (revenue farmers) of Bengal in return for an annual tribute of Rs. 26 lakhs. The gross revenue of the Company, apart from trading profits, was estimated by Lord Clive himself at Rs 2.5 crores per year.[2] The surplus to be remitted to England, after meeting all expenses and tributes, would amount to Rs. 1.22 crores of *Sicca* Rupees.

Lord Clive was determined to maintain the Company officials' monopoly in respect of the internal trade in salt, betel-nut and tobacco, though in other respects he adopted measures to keep such unauthorised private trade in check.

The Company had got into the revenue farming business in 1760 when three districts of Bengal (Burdwan, Midnapore and Chittagong) had been assigned in their favour by the then Nawab of Bengal,[3] Mir Kasim.

1. Dutt, R.C., *The Economic History of India, 1757–1837*, pp. 18–19.
2. Dutt, R.C.. *op. cit.*, p. 26.
3. In 1759 the Company was recognised as zamindar of 24-Parganas. The Company directly administered this estate, whereas the 1760 assignment gave rise to an indirect form of administration which foreshadowed the subsequent Permanent Zamindari settlement.

Although the deed of assignment granted to the Company provided for maintaining intact the rights of hereditary revenue-collectors (zamindars) in these districts, these rights were in practice ignored and estates were put up for auction to the highest bidders. This kind of practice paved the way for the emergence of a class of speculators and rack-renters while many of the traditional zamindars were forced to sell off their estates.

The *Diwani* rights acquired from the Mughal Emperor in August 1765 immediately gave rise to the problem of finding out the best method of collecting the revenue. Experiments for finding out what the land will fetch were made by giving out land on lease by open auction for one to three years at a time. But it was not long before the Company's officials discovered that these speculative bidders for revenue-collection rights would very often run into heavy arrears and there were few methods by which they could be made to clear off their dues. At the same time, in order to fulfil their commitments to the East India Company, these short-period lease-holders would squeeze the tenants in every possible way without caring for the future effects of such harassment on the morale of the cultivators or the standards of cultivation. A sentiment grew among a certain section of the Company's officials that the traditional zamindars, who were hereditary farmers of revenue and local administrators of civil law under the Mughals, should receive preference of treatment in any system of revenue farming. Following this line of thought Warren Hastings's government entered into five-year farming arrangements in 1772 mostly with local zamindars. But since the actual revenue-yielding power of the territory was still an uncertain magnitude, the system of public auction of estates continued side by side. In the years following the great Bengal Famine of 1770 (Bengali *sal* 1176) many estates changed hands at rather inflated prices, since crop prices had reached unprecedented heights. Subsequently, when crop prices fell owing to bumper harvests the revenue burden turned out to be excessive. Unable to meet their obligations to the Company, the short-lease revenue farmers applied the screw on the cultivators once more with the result that by 1780 about one-third of the sown area of Bengal was reported to have gone out of cultivation.

In the early years after the assumption of Diwani rights the Company was careful to maintain the appearance that it administered the revenues on behalf of the Mughal Emperor. But by the time of Warren Hastings the Company's authority began to be asserted in clear and unmistakable terms. Certain vestiges of Mughal rule, however, continued to linger until 1803 when the East India Company openly asserted its supreme authority by de-recognizing the Mughal Emperor.

In 1765 the revenue administration was placed under a native official of high status, the Naib Diwan, who was to be supervised by a British official called the Resident of the Durbar. The Resident was to be under the control and regulation of the Select Committee functioning from Calcutta.

The Naib Diwan (Mohammed Reza Khan) in order to satisfy the new masters of the country's destiny directed his subordinates to make larger demands on the revenue farmers in the province. Customary restraints on the enhancement of the land revenue were largely ignored. In 1769 it was decided to nominate junior European servants of the Company as Supervisors of Revenue in the principal centres of revenue administration. They were to supervise the native *amils* (collectors of revenue from the zamindars) and to draw up an account of the state of cultivation in the areas under their charge so that fair revenue could be fixed. But partly owing to their inexperience, partly owing to the prevalence of corruption among the Company's junior officials and partly owing to lack of co-operation from the native revenue staff, this move failed to produce the desired results. Many of the English Supervisors of Revenue were more interested in profiteering at the expense of the native trader than in improving the revenue collection for the Company's benefit.

In July 1770 Councils of Revenue came to be formed at Murshidabad and Patna and in 1771 a Comptrolling Committee of Revenue was set up in Calcutta. The latter took over from the Select Committee the function of supervising the province's revenue administration. In 1772 the office of the Naib Diwan was abolished and the Company decided, under instruction from its Court of Directors in England, to assume sole charge of the revenue administration. The Supervisors of Revenue came to be designated as Collectors and the revenue treasury was removed from Murshidabad to Calcutta. Two years later the Collector's post was abolished and five Provincial Councils were set up at Calcutta, Murshidabad, Burdwan, Dinajpur and Dacca to look after the revenue administration. Each Council consisted of five members and had attached to it the post of a Diwan who would be a native official. The work of the Provincial Councils came to be regulated by a Revenue Board consisting of all the members of the Council at Fort William, Calcutta. In 1781 the system of Provincial Councils in its turn was given up and the old system of administration by Collectors was restored. The Revenue Board was replaced by a Committee of Revenue constituted by five senior servants of the Company. In 1786 this body came to be designated as the Board of Revenue. All these changes, however, failed to improve revenue collection to the satisfaction of the Company's Directors. Balances of revenue continued to accumulate. Many of the revenue farmers came to be lodged behind prison bars for failure to meet their commitments but this did not improve the realisation of revenue. Not being "men of substance and character," many of them were not inclined or able to buy back freedom with money.

The enhancement of the revenue burden on the zamindars of Bengal appears to have commenced since the days of Mir Kasim who was anxious to collect as much revenue as possible in order to prepare for a decisive war with the British usurpers. His policy of ignoring the traditional usages in

respect of revenue rates was continued and even intensified by the Company and its agents after 1765. In the terrible Bengal famine of 1770 the pressure of the enhanced revenue demand proved so disastrous that many zamindars and farmers fled the land and much land went out of cultivation.[4] As zamindaris came to be put up for public auction under the British, many adventurers came forward hoping to make a profit, even if for a very short term, by rack-renting the cultivators. The abuse of the system of revenue farming, combined with public auction of zamindaris, was so great that the Company found it necessary to introduce in 1772 a system of 'Five-Year Settlement' of revenues giving special preference to zamindars in the settlement of revenues. But so long as outsiders could bid for farms without any clear idea of their revenue-yielding capacity, defaults of revenue could not be altogether avoided. Yet some zamindaris were distinctly profitable and many of these highly profitable farms came to be acquired by senior servants of the Company, in the name of Indian agents, to the detriment of the interest of the traditional zamindars.

The Five-Year Settlement was abandoned in 1777 and for the next twelve years Annual Settlements became the practice. In these Settlements also preference was given to the zamindars and a standard assessment of revenue was made on the basis of the net revenues received into the treasury during the preceding three years. Even this method of assessment proved to be excessive in many cases since, as noted above, high prices after 1770 had given an upward bias to all farming agreement terms.

Permanent Settlement in Bengal, Bihar and Orissa

As early as 1772 Warren Hastings had expressed the view that settlement with the zamindars was the only way out of the chaos into which the Company's revenue administration had fallen. He was in favour of settlement for a fairly long period, "for a life or two joint lives". Philip Francis, Hasting's main antagonist in the official hierarchy at that time, was in favour of making the zamindari settlement unalterable for all time since, in his view, "the Government could not descend to the level of the ryots." In spite of their differences on many points, both of them agreed that the traditional zamindars were the natural leaders of the local communities in which they lived and that outsiders would not be inclined to protect the interest of the ryots to the same extent as the zamindars would do.

After the experiments of the five-yearly and shorter revenue settlements most of the Company's officials came round to the view that a relatively permanent land settlement was the need of the hour. The Court of Directors

4. One important reason for the enhancement of the revenue burden was the system of *najai* which required the survivors after a natural disaster (*e.g.*, famine) to make good the loss of revenue due to the death or desertion of fellow-villagers.

of the East India Company and the British Government which, by Pitt's India Act of 1784, had assumed considerable control over the Company, now wanted revenue farming experiments to stop. Lord Cornwallis came out to India as Governor-General in 1786 with specific instructions to give effect to this policy. He himself also believed that only by making a once-for-all settlement with the native zamindars regarding the land revenue could the Company's limited administrative resources in India be freed for other and more important tasks.

Cornwallis was interested primarily in securing a guaranteed income for the Company. He was aware that this would involve a foregoing of the Government's share in the enhanced income from land in future. But he was confident that the loss could be made good by duties on trade and commerce which would flourish if agriculture became more prosperous. He could have little interest in the fate of the traditional zamindars of the country. Rather he wanted land to pass into the hands of the more vigorous commercial classes of the country who would then spare no resources to bring the waste lands into cultivation and thus usher in an Agricultural Revolution in the country in the same way as British landlords had done in England. As for the rights of the ryots against the zamindars, Cornwallis thought that he could leave them to the zamindars' good sense. So long as uncultivated land remained to be taken up, the zamindars, he believed, would never drive out ryots or rack-rent them. He had no doubt that zamindars would grant written deeds of agreement (*pattas*) to their ryots and any violation of the terms of the deeds would be promptly referred by either of the parties to the agreement to the law courts which his government was speedily setting up in different parts of the country. With his aristocratic background and his eighteenth-century rationalist outlook Cornwallis could foresee neither the disability of a ryot to file law-suits nor the failure of the courts to dispose of cases in time!

Sir John Shore, who had greater experience than Lord Cornwallis in Indian revenue matters, advised a certain amount of caution in making the revenue settlement permanent without first undertaking a comprehensive enquiry into rent levels, agricultural incomes and other relevant matters. His advice did not receive the attention it deserved. In 1789 Lord Cornwallis's government entered into Decennial Settlements with the zamindars of Bengal, Bihar and Orissa, with the provision that the current rate of assessment could be made permanent later with the approval of the Court of Directors. This approval was received in 1792. The Court of Directors instructed the Government of India to convert the actual revenue collection of 1789-90 into a permanent demand on the zamindars.

The Permanent Settlement was announced on 22nd March, 1793. The revenue demand on zamindars was fixed at 9/10ths of the rent which they were assumed to collect. Since the latter amount was unknown, it is difficult to say definitely whether the revenue assessment of 1793 was too burdensome

on the zamindars, as some have claimed.[5] The real hardships of the system arose from the severity with which defaulters of revenue were treated. The zamindars were made liable for the punctual payment of their instalments of revenue into the Company's treasury. Any failure to discharge their obligation would immediately result in the sale of such portions of their estates as would be necessary for the realisation of their dues. To enable the zamindar to collect his dues from the ryot he was armed by Regulation VII of 1799 with the powers of putting his tenants in a lock-up for non-payment and of selling off their personal chattels for the realisation of arrears of rent. Regulation V of 1812 to some extent sought to reduce the abuses of the unlimited power of distraint previously conferred, but the legal protection afforded to ryots against the zamindar's powers was totally inadequate.

There was at this time no definite record of rights to which the ryot (the actual cultivator) could turn in case of enhancement of rent or eviction. What made the situation more grave was the power conferred on buyers of zamindaris in auction sales to terminate all previous agreements. Eviction of settled farmers became a common occurrence and rent levels were enhanced in violation of established usage. Lord Cornwallis's assurance that zamindars would grant a written *patta* clearly stating the terms of tenure to every cultivator, was ignored by the local administration. The exactions of the new zamindars became in most cases entirely arbitrary. Quite often the right of rent collection would be relegated to subordinate agents who would then impose their own assessment on the ryots. Zamindari estates came to be purchased in auction by city-dwelling commercial interests, as Cornwallis had envisaged, but they hardly invested new capital for the improvement of land. In most cases, they would leave the collection of revenue to the previous owners, now functioning as *patnidars* under the new zamindar.

The demand for cultivable land was going up in the early part of the 19th century for more than one reason. The relatively settled condition of the country and freedom from major dynastic conflicts were perhaps responsible for a somewhat more rapid growth of population in the country. The displacement of handicraft products by machine-made goods obliged many artisans to bid for land on any terms. In response to this enhanced demand for land, eviction of existing tenants paying lower rents became quite frequent. The value of zamindari estates also rose markedly. Values fetched at auction by such estates during 1813–14 were about twenty times their average value during 1790–93.

5. In fact zamindars whose territories were already thickly populated suffered under the system. Zamindars living in remoter areas benefited from the current under-assessment of their lands.

Revenue Administration in Other Presidencies

In South India the struggle for power between the British and the French ended in the former's favour with the signing of the Peace of Paris in 1763. Although the Nawab of the Karnatic remained as the visible power, British authority reigned supreme. A part of the Nawab's revenue was assigned to the British for affording him military protection. The British demand increased as the years passed, and the poor Nawab was forced at first to borrow from British creditors and finally to deliver up to his creditors the right to revenue. The cultivators thus passed from the rule of the Nawab's agents to the rule of the British moneylenders.

In the Northern Circars (the north-eastern region of today's Andhra Pradesh) a five-yearly settlement was made in 1778 with the zamindars, the level of revenue being about two-thirds of the gross collections of the zamindars. In 1777 the Court of Directors of the East India Company directed that a Committee of Circuit should be appointed to inquire into the gross revenues of the region and the rights of zamindars and cultivators. The Committee was set up, then disbanded, but restored in 1783, it continued its work until 1788. Permanent Settlement of the Bengal type was generally extended into the Northern Circars between 1799 and 1802. Territories acquired in the South after the Company's war with Haidar Ali were however settled on a different basis. The Ryotwari Settlement in the South is associated with the name of Sir Thomas Munro, just as the Permanent Settlement in Bengal is associated with the name of Lord Cornwallis.

Over the period 1807–20 there was a continuous debate regarding the relative merits of (*a*) Permanent Zamindari Settlement, (*b*) Permanent Ryotwari Settlement, and (*c*) Permanent Mauzawari Settlement. Munro in his famous report dated 1807 favoured the system of permanent ryotwari settlement at roughly one-third of the gross produce. The existing level of land revenue was nearly 45 per cent. Occasionally a revenue settlement would be made with a whole village (Mauzawari or Mahalwari Settlement), usually for three years, but a proposal to make this mode of settlement decennial with a view to permanency was promptly rejected by the Court of Directors. The decision in favour of a Ryotwari system with periodical revisions of the revenue demand was made once for all in 1820, though arguments in favour of the other rival forms of settlement continued to be pressed from time to time.

Land Settlement in North-West India

Parts of Uttar Pradesh came into British possession between 1775 and 1856. Initially it was the Bengal-type permanent settlement that was favoured, but later, after 1811, considerations of sacrifice of revenue led to abandonment of fixity of revenue. In 1822 the principle of landlord or mahalwari

settlement for a fairly long term was accepted by the authorities. It was held that the State was entitled to 83 per cent of the gross rental of the landlords' estates and this settlement was liable to be revised from time to time.[6]

During the Governor-Generalship of Lord William Bentinck the policy was adopted of lowering the revenue demand on the estates and extending the period of settlement. In 1833 the revenue demand was reduced to 66 per cent of the rental and the settlement was made for 30 years. But although a smaller fraction of the rental was now to be collected by the State, the assessment of the gross rental itself presented a number of problems and a great deal had to be left to the judgment of the local Settlement Officer.[7] This naturally gave rise to some uncertainty regarding the ultimate liability of the revenue-payer. The settlement operations themselves took over 16 years to be completed.

Although the State's share of the gross rental had been reduced from 83 per cent to 66 per cent, the liability was still excessive. Hence, a new basis was introduced in 1855 in connection with the re-settlement operations then being conducted in Saharanpur district. The so-called "Saharanpur Rules" of revenue settlement contained the important provision (Rule 36) that land revenue would constitute 50 per cent of net produce in the case of owner-cultivators or 50 per cent of net rental in the case of estates held by non-cultivating proprietors. This practice formed the basis of subsequent revenue settlements in other parts of the country.

Land Settlement in the Bombay Deccan

After the last Mahratta War in 1817, substantial parts of the Bombay Deccan came under British rule. Conditions in these parts of the country at that time were reflected in Elphinstone's Report prepared in 1819 and in Chaplin's Reports of 1821 and 1822. Both of them brought to the Government's attention two characteristic institutions of these regions: the existence of well-knit village communities under a recognised village head, and the prevalence of heritable land rights among cultivators paying a *fixed* land tax to the Government. These institutions, encouraged under Mahratta rule, received little recognition in the British Government's new revenue settlements. The alien Administration set its face against accepted tradition and decided to enter into separate revenue arrangement with each cultivator, thus by-passing the village head. At the same time, it provided for the periodic revision of revenue demand, ignoring the established practice of a fixed land tax.[8]

6. Dutt, R.C., *Economic History of India, 1837–1900*, p. 23.

7. The overall supervision of the settlement operations was entrusted to R.M. Bird, who submitted a report on the subject in 1842. See Dutt, *op. cit.*, p. 25.

8. Dutt, R.C., *op. cit.*, Ch. 4.

Temporary revenue settlements were hastily introduced in different districts of the Bombay Deccan immediately after its conquest. Subsequently measures to establish revenue demands on a more settled basis were initiated in 1824–28.[9] The revenue demand was fixed at 55 per cent of the produce, but the measurement of the area and production was generally regarded as highly unsatisfactory. The assessment proved to be excessive. Many cultivators abandoned their land and fled to the neighbouring Native States. Nearly one-third of the cultivated area is reported to have gone out of cultivation.[10]

In 1835 area-survey of the region was ordered.[11] This work continued almost up to 1872. The entire land in the several districts was classified into nine different categories according to quality. The assessment for an entire district was based on an enquiry into its general circumstances and previous levels of assessment. The total demand was then distributed among villages and fields according to the quality of the land. The assessment, it may be noted, was conducted without any reference to the cultivator. He was asked to pay a certain rate and if he pleaded his inability to pay at that rate he was required to quit. This new assessment too was not much better than the previous one, being largely based on guess-work. The burden of assessment might vary from one district to another depending on the judgment of the District Settlement Officer. Although the Settlement was for a period of 30 years the possibility of enhancement of rates in subsequent re-assessments contributed to a feeling of insecurity among cultivators. The decade of 1840–50 saw the recurrence of controversy regarding the merit of such temporary Ryotwari Settlement. It was pointed out that over-assessment was causing misery to the peasants. The element of uncertainty regarding the next settlement was holding them back from effecting permanent improvements on their soil. These problems could be overcome only by making the revenue demand permanent. The advocates of the Ryotwari system on the other hand contended that, bereft of the evils of over-assessment, the system was beneficial to the ryot. The conditions of success of a Ryotwari Settlement were recognised as follows:[12]

(*a*) a moderate and equitable assessment, leaving a fair proportion of the economic rent (or surplus) to the proprietor;

(*b*) a fairly long period of settlement, say, 30 years;

(*c*) security against increase of revenue demand, on any ground whatever, during the term of the settlement;

9. The settlements were conducted by Mr. Pringle of the Bombay Civil Service.

10. Dutt, R.C., *op. cit.*, Ch. 4.

11. This survey was conducted by Mr. H.E. Goldsmid and Capt. Wingate. The rules of the settlement were finally compiled in 1847 by these two gentlemen together with Capt. Davidson and were embodied in what is known as the *Joint Report*.

12. Messrs. Goldsmid and Wingate's letter to Revenue Commissioner of Poona, dated October 19, 1840, excerpted in Dutt, R.C., *op. cit.*, pp. 40–41.

(*d*) recognition of property rights, subject to payment of assessed land revenue;

(*e*) facilities for sale and transfer by apportionment of assessment on portions of land that could normally be transferred;

(*f*) perfect freedom regarding leasing out or sale of land;

(*g*) exemption of uncultivated portions of land from the assessment.

The major difference between the revenue settlements in North-West India and those in the Deccan was that, while both were based largely on guess-work, the former related to an entire estate or village, while the latter concerned each separate field. This implied, as Romesh Dutt pointed out many years ago, that in the former case if the settlement officials' guess-work went wrong the land-holders could collectively agitate and were likely to receive hearing from the settlement officials; in the latter case, the protest was more likely to come from an individual who was unlikely to receive redress. In this sense the ryotwari settlement might be even more oppressive than the landlord or mahalwari settlements.

The opponents of the Bombay system of Ryotwari Settlement were also very sore on the points that the system had swept away all intermediaries, ignored the useful role of village communities and community officials and had left no cushioning influence between an alien government and a vast multitude of helpless cultivators.[13] It had thus opened up the way for excessive assessment without however making suitable provision for the timely redress of landholders' grievances.[14]

Land Settlement in Madras Presidency

The Ryotwari system of revenue settlement was introduced gradually in the different districts of Madras[15] following the acquisition in 1792 of some districts in that region by the East India Company. The early assessments were soon found excessive; at one-half of the gross produce they often absorbed more than the whole of the 'economic' rent or surplus. In 1807 it was proposed to reduce the assessment to one-third of gross produce, but the proposal fell through owing to pressure for increased revenues from the East India Company's Court of Directors. From time to time, proposals came up for the recognition of village communities' role in the revenue administration. But the Court of Directors had by this time become reluctant to recognise any intermediate bodies in their dealing with the cultivators

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13. Madras Board of Revenue also criticised the system in 1818. The Sadar Board of Revenue protested against the extension of the system in 1838.

14. Dutt, R.C., *op. cit.*, pp. 41–43.

15. Madras Settlements were carried out under the supervision of Sir Thomas Munro and Captain Read.

Reduction in the burden of assessment to nearly one-third of the gross produce was gradually brought about during 1820–27 when Sir Thomas Munro, who had originally suggested such reduction, himself became the Governor of Madras. But even this reduced demand was excessive in many instances, particularly since the demand was a fixed sum while output and crop prices were variable from year to year. The agents through whom revenues were realised were extremely low-paid and hence tended to add their own exactions to the Government's demand. Famine during 1830–33 filled the cup of misery for the peasants. At the same time, the absence of any kind of lease arrangement perpetually prompted the ryot to feign poverty and seek remissions of revenue whenever possible.[16] Corrupt practices such as bribing the *tahsildars* (revenue collectors) existed side by side with grievous tortures on peasants unable to clear their dues in time.

Some reform measures were introduced in Madras following the Parliamentary enquiries of 1852 and 1853 into the revenue administration there. A careful survey and settlement of the entire province was decided upon in 1855 with a view to bringing about such reduction in the assessment as would leave some profits of cultivation to the cultivator and would at the same time discourage corrupt collusions between prosperous farmers and *tahsildars*. The new settlement operations began in 1861, the districts being taken up gradually one after another. Assessments were now fixed for thirty years at a rate approximating one-half of the net produce. In irrigated areas the irrigation cess was, however, consolidated with the land revenue after 1897, thus making it obligatory on all farmers in irrigable areas whether they actually used irrigation water or not. This in effect enhanced the burden of revenue assessment although the declared intention was to reduce this burden.

Land Settlement in the Punjab

The Punjab came into the possession of the British East India Company between 1846 and 1849. Almost immediately the prevailing system of collection of revenue in kind was replaced by collection in cash. However, the initial assessments, made under the supervision of British officials,[17] helped to abolish some of the oppressive features of the Sikh revenue system. But the humiliating defeat of the Sikhs in 1849 opened up the way for more far-reaching changes in the revenue system. Under Lord Dalhousie's inspiration, the policy was adopted of uprooting traditional village leaders and ignoring the existence of village communities. Eager to establish a direct link between the Government and the people, the new administrators

16. Dutt, R.C., *op. cit.*, pp. 53–54 quoting from Campbell, G., *Modern India.*

17. They worked under the close supervision of Henry Lawrence, an able East India Company official who was Resident at the Sikh Darbar.

introduced the Ryotwari form of revenue settlement in the Punjab at one-third of the gross produce payable in money. But even such a comparatively low level of assessment, undertaken as a rule of thumb, was very often found exorbitant. The Administration reduced the land revenue at first to one-fourth and then to one-sixth of the gross produce. These prompt measures of reform succeeded in improving the conditions of farming in the province as well as in securing additional revenues for the government.

Settlement operations on a continuing basis started in the Punjab in the early 1850s and were nearing completion when the Mutiny broke out in 1858.

Two Principal Forms of the Ryotwari System: The 'Net Produce' (Madras) System and The 'Net Asset' (Bombay) System

In Madras the ryotwari system of settlement was based on the principle that the land revenue would appropriate a fraction, usually 50 per cent, of the 'net produce' of a farm, that is, the gross produce less the expenses of cultivation including the farmer's own wages and those of other members of his family. The gross produce would be calculated on the basis of a series of experiments regarding the productivity of land in the recent past. This would be valued at the average price of twenty non-famine years immediately preceding the settlement. Once the soil was classified on the basis of its innate productivity, no further re-consideration of its capacity to produce would usually be made in future settlements. Only the change in prices of agricultural crops during the interval between two settlements would be taken into account in revising the revenue demand. It may be noted that 50 per cent of the net produce was to be claimed only in the case of land having the greatest natural advantages. For land which was inferior in respect of fertility or locational advantages, the share of the net produce taken as land revenue would be generally lower.

In Bombay, after various initial experiments, the assessment came to be based on the relative value of the soil in the ryot's possession without any consideration of the yield. The soil would be classified according to certain physical characteristics, such as texture and capacity to retain moisture. The best quality of land in a locality would be designated as 16 annas land, while other land would be similarly expressed in terms of annas in a number of gradations. After the soil in a certain area was thus carefully classified, the revenue demand for the area as a whole would be determined on the basis of general considerations and historical data about revenue collections and prices. This total demand would then be apportioned among the holders of land according to the amounts of different types of soil which comprised their holdings. The level of revenue demand was thus graduated, somewhat empirically, according to the relative quality of the soil.

With the passage of years the classification of land based on a general assessment of soil characteristics came to be regarded as at least partly arbitrary and the authorities slowly and imperceptibly tended to take the prevailing rental values as guide-lines for the determination of the relative values of different classes of soil. Nevertheless the Bombay system remained distinct from the Madras system in that no estimate of the value of the produce was ever required to be drawn up before the land revenue demand was finally fixed.

A Summary

The position relating to land revenue settlements in the middle of the nineteenth century can be thus summed up in the words of an eminent historian of Indian economic life:

"In Bengal land was held by landlords paying a fixed and unalterable land tax to the government. In Northern India it was generally held by landlords paying a land tax revised at each new settlement. In Madras and Bombay it was generally held by peasant proprietors who paid a land tax revised at each new settlement. In the Punjab it was generally held by peasant proprietors living in village communities, each village collectively paying the land tax which was revised at each new settlement.

...the land tax gradually became a uniform rate, at least in theory. In Bengal it was about one-half the rental in the middle of the nineteenth century. In Northern India it was fixed at one-half the rental by the Saharanpur Rule of 1855. In Bombay and Madras Sir Charles Wood fixed the land tax at about one-half the economic rent in 1864. And in the Punjab the government demand was reduced to one-half the rents ordinarily paid by tenants-at-will."

Economic and Other Effects of Different Forms of Land Revenue Settlement

The Permanent Settlement introduced in 1793 fixed the land revenue demand of the State in perpetuity. This was intended to encourage the intermediaries, with whom the Permanent Settlement had been concluded, to lease out their lands in the most profitable manner and to settle uncultivated land with tenants by giving them favourable conditions of tenancy. At one time it was contemplated that the benefits of permanence in tenurial conditions would be extended to the actual cultivator himself. This idea, however, was not quite consistent with the objective of putting land to the most profitable use through the encouragement of competition among tenants. Moreover, one must bear in mind that the years following the introduction of the Permanent Settlement saw an upsurge in population and in the demand for land. In such a situation it was hardly practicable to secure fixity of tenures and a permanent rental demand for *all* classes of tenants.

The East India Company entered into a permanent revenue settlement with the zamindars not so much because they had any intention of ignoring the interests of the ryots and safeguarding those of the zamindars, but because they were greatly in need of a stable revenue for themselves and felt that the zamindars were the only class of people who could be reasonably expected to fulfil their commitments. A permanent revenue settlement with the ryots was dismissed as impracticable because the government did not have the necessary revenue staff to put such a system into operation. Contemporary English experience appeared to indicate that a class of landlords could confer immense benefits on tenants by introducing various improvements in farming practices. It was Lord Cornwallis's firm conviction that the vigorous commercial class in India would enter the farming business in large numbers as soon as the uncertainties of land revenue demand were ended by the introduction of a Permanent Settlement. Something like this could perhaps have happened if the demand for creation of small tenant holdings did not increase sharply in consequence of the growth in population and the shrinkage of industrial occupations.

The Permanent Settlement no doubt involved the sacrifice of the State's claim to future increases in the value of agricultural production. This in its turn implied that the State in India could not undertake works of economic benefit for the people to the same extent as a State with more elastic revenue resources could do. Nevertheless the system led to the channelling of the 'surplus' from land into the hands of a relatively small class of landlords and to that extent created conditions favourable for raising the level of private investment. The number of people sharing in the rental income from land, however, increased as the years passed. Sub-infeudation of estates came to be the commonly accepted practice with almost all classes of landlords. Although there might still be quite a few landlords who commanded sufficient investible resources, they were often not enterprising enough to invest funds for agricultural improvement but preferred safer outlets for their funds in the form of government securities and the like. It must be admitted, however, that the more prosperous section of landlords often made generous gifts for social and educational purposes and thus indirectly contributed to economic development in the country.

The zamindars were not only the main prop of the British revenue system in some parts of the country; for a long time they were also looked upon by the British administrators as occupying only the next rung below them in the social hierarchy. In the circumstances the zamindars, or at least the majority of them, pathetically clung to the British for the security of their rights and possessions. As national fervour was built up in the closing years of the nineteenth century, the zamindars naturally came to be looked upon as pro-British and anti-people.

It was primarily the sacrifice of revenue involved in the Permanent Settlement that led to a swing in official opinion against this mode of settlement.

After the first few years of the nineteenth century most of the revenue settlements made were on a temporary basis. Temporary settlements were made (*a*) with zamindars, as in some parts of Uttar Pradesh and Madhya Pradesh, or (*b*) with a village group, as in some other parts of M.P. and Punjab, or (*c*) with ryots as in Bombay, Madras and other areas.[18] The trouble with all temporary settlements was that, if the period of revenue settlement was very short, the farmers might not feel it worth their while to effect any improvements on their land, particularly when it was their experience that little allowance was made at the time of the resettlement for works of improvements undertaken bv the farmer. As settlement operations had to be preceded by surveys and other inquiries the farmer might have to spend a lot of time in arguing his case for a relatively mild revenue demand. Since official instructions on the mode of assessment were not very definite in the initial years, the Settlement Officers would have to exercise their judgment in fixing the revenue demand. This left much to the personal whims of an officer and quite often he or his subordinates might be won over to his side by a farmer with some local influence. The system also gave rise to litigations and counter-litigations.

The period for which a temporary settlement was effected was very short in the beginning. Annual or triennial settlements were quite common. No very definite rules existed for the fixation of the revenue demand and revenue officials generally followed the method of adding an arbitrary increment on the recently prevailing levels of land revenue in the locality. As the nineteenth century advanced, the settlement operations became more systematic[19] and the period for which a particular settlement remained valid was extended to 20–40 years, the most common period being 30 years. The reasons for which revenue demand could be enhanced in a subsequent re-settlement operation were clearly and unambiguously set forth in the Revenue Codes. These changes helped a lot in mitigating the unwelcome effects of a temporary settlement.

But in the cases where a temporary settlement was reached with a class of landlords, the tenants were left without much protection against their land-owning masters. Rack-renting and eviction would be common, particularly when the landlords themselves got burdened after a settlement with additional demands. The customary rights enjoyed by *khudkast* ryots under Mughal revenue administration[20] lost most of their significance in

18. In 1928–29 categories (*a*) and (*b*) accounted for 30 per cent of the total cultivated area, while category (*c*) covered 51 per cent. The remaining 19 per cent was permanently settled. See Jathar, G.B. and Beri, S.A., *Indian Economics*, Vol. I, 5th Ed., p. 406, f.n.

19. Although, because of the large-scale disruption which a settlement caused to the even tenor of village life, it was often characterised as an 'unsettlement' operation!

20. *Khudkast* ryots were those recognised as resident members of the local village community, often bound by kinship relations. Their rights were superior to those of *paikast* ryots who were looked upon as in-migrants and outsiders.

the process. The traditional communal life in the village was also disrupted as a particular person came to bring his authority to bear on the rest of his fellow-villagers. In looking for the landlord the Settlement Officers had often to brush aside the healthy practice that traditionally prevailed of making the village jointly responsible for the revenue and assigning the function of distributing the revenue burden among the villagers to the village headman.

The temporary settlement with individual ryots, known as the ryotwari settlement, totally ignored the important role of the village community. The system was also expensive in that settlement operations had to be conducted on a much more extensive scale in ryotwari areas than in the zamindari or mahalwari areas. The ryots being men of small means could not stand up against an enhanced assessment as zamindars could, so that the levels of revenue were generally higher per unit of cultivated area in the ryotwari provinces.[21] The differences in revenue incidence, however, were attributable to other factors as well, such as differences in fertility of soil, irrigation facilities, etc., and should not be taken as due entirely to the helplessness of the individual ryots.

In fact, the ryot with whom a revenue settlement was made in the ryotwari areas could, in favourable circumstances, become a rentier himself by leasing out a portion of his land to some of his less favourably situated co-villagers. With the growth of population in the country-side and rise in agricultural prices in the period between settlements, the landlord-tenant relation emerged in some measure even in the areas of ryotwari settlement. Another factor in the creation of tenancies and sub-tenancies all over the country was the alienation of land from the ryots to the money-lending classes. In the pre-British days land was not a marketable asset, but under the British system of law land could be pledged to obtain a loan. Failure to repay the loan led to the transference of ownership rights to the money-lender, with the former owner clinging to his only means of livelihood as a tenant on almost any terms. Until recently the plight of such tenants received little consideration from the ruling authorities, since the primary aim of the land revenue administration in British India was not the improvement of the farmers and their systems of farming,[22] but simply to obtain

21. In 1933-34 the incidence of land revenue per acre of cultivated area was Rs. 2.62 in the Madras ryotwari districts, while in Bengal in 1936–37 land in a permanently settled area had to pay in revenue only Re. 0.93 per acre. In the temporarily settled landlord estates of Bihar in the latter year the incidence of land revenue per acre was about the same as in Bengal. See Nanavati, M.B. and Anjaria, J.J., *The Indian Rural Problem* (1944), p. 123.

22. *Cf.* Macaulay's comment on East India Company's revenue administration: "Govern leniently, but send us more money, practise strict justice and moderation, but send us more money, be the father and oppressor of the people, be just and unjust, moderate and rapacious". Macaulay, *Essays on Warren Hastings*, p. 25, as cited in Raman Rao, A.V., *Economic Development of Andhra Pradesh, 1766-1957.*

for the authorities an assured revenue, at the same time maintaining an appearance of fairness in the rulers' dealings with the more vocal sections of society such as the zamindars and the richer ryots.

Merits and Drawbacks of the Permanent Settlement: Romesh Chandra Dutt and Later Commentators

In 1775 the proposal for a permanent settlement of land revenue "with such reasonable people as shall offer the most advantageous terms" was put forward by Warren Hastings and another member of his Council. The zamindar was to be allowed a preference in effecting such a settlement, but concern for the zamindar's rights or fate was not the principal motive for favouring a permanent settlement with the zamindar. The principal argument was "the security arising from the power of selling their (zamindars') lands when landed property is put upon such a footing as to become desirable". It was the assurance flowing from the ready marketability of zamindari rights which inspired the proponents of a permanent settlement to hit upon such an arrangement. To this was added the eminently pragmatic argument that so long as revenue settlements were periodically made, a large part of the administrative business of the Company was taken up with finalising the terms of the settlement. Once a permanent revenue settlement was brought into being, the administration could let the law against defaulters take its own course and zamindari rights could automatically pass into the hands of the most energetic sections of the people. Nothing but good was expected to emerge from a system which thus ensured permanent possession of property with an unchanged land revenue demand to an enterprising group of zamindars. The system was expected to "awaken and stimulate industry, promote agriculture and extend improvement, establish credit and augment the general wealth and property". This general increase in wealth would, in course of time, make up for the sacrifice of State revenues which was an immediate consequence of the permanent settlement.

Among Indian thinkers on the State's land tax policy, the late Romesh Chandra Dutt was an ardent supporter of the permanent settlement principle. In his view, this was "a measure which has done more to secure the prosperity and happiness of British subjects in India than any other single measure of the British Government". Historically, no doubt, the permanent settlement was an improvement on the harsh and uncertain revenue settlements which preceded it during the period 1765-1793. But while superior landlords derived benefit from the secure rights which the permanent settlement conferred on them and from the subsequent increments in rental values brought about by the growth of population and the extension of cultivation, the actual cultivator was not in the least benefited. He continued to suffer from the same insecurity and harshness of treatment which had been his lot since his customary rights began to go by default in the

great social and political confusion of the times. In fact, as traditional zamindars (who might be punished, but were hardly dispossessed, during Mughal times) began to lose their property and landed estates passed into the hands of the commercial classes, rack-renting of the cultivator appears to have increased. Since default by the zamindar was not condoned by the Company, the zamindar was not in a position to grant remissions to the ryot even when the ryot's circumstances called for such remission. This development of the permanent zamindari system was somehow not expected by its sponsors. Lord Cornwallis, for example, believed that the benefit of secure possession at a fair rent would be extended by the zamindar to the ryot. So long as land was remaining uncultivated, the zamindar could not but lure cultivators to land with the best of terms. It could not be foreseen at the time that population growth and the almost total destruction of the principal handicrafts would so increase the demand for land that the zamindar's interest would be better served by denying his ryots the benefits of security.

As prices of crops and rental values of agricultural land shot up in the early years of the nineteenth century, the zamindar found it convenient to arrange for rents to be collected through *patnidars*, *ijaradars* and other intermediaries. The latter would hold estates under a zamindar, paying him a fixed rent, but would be left free to make it up for themselves by imposing higher rents on the ryots. This process of sub-infeudation went to extreme lengths in some permanently settled areas as rental values, determined by market forces, continually rose. Investment in zamindaris and other intermediary rights at one time became more sought after than investment in commercial and industrial ventures, particularly since the former yielded a more or less certain income while income from the latter was uncertain. The permanent settlement is thus required to bear some share of the blame for the Indian's lack of enterprise in commerce and industry. Perhaps it would be more correct to say that in the nineteenth century investment in land offered Indian capital a refuge when it was being dislodged by foreigners from the more lucrative, though more uncertain, commercial and industrial enterprises.

At the same time, one has to recognise that the permanent settlement created a land-holding middle class whose incomes, though sometimes used for frivolous consumption, did add to the community's stock of wealth in various forms. In a number of cases patronage was extended by this class to education, music, the fine arts and to the movement for political and social emancipation. At a time when the government of the country was in unsympathetic foreign hands, these useful activities would probably have languished if the surplus accruing to the landed gentry went instead to the State.

When in the present century the substance of power came to be transferred to Indian hands and the Government of India became more responsive

to public moods, the system of permanent zamindari settlement very naturally began to look like an anachronism. Under the Constitutional reforms of 1935 a popular Ministry in Bengal set up the Land Revenue Commission (Chairman: Sir Francis Floud) in 1938 to study the working of the permanent settlement and suggest necessary reforms. In their report, published in 1940, the majority of the Commission recommended abrogation of the permanent settlement and supported a system in which the Government would remain in direct touch with the actual tillers of the soil. The minority, however, did not expect much gain from zamindari abolition unless other measures of rural improvement were simultaneously taken in hand. The controversy between the supporters of the status quo and the advocates of abolition of all intermediate tenure-holders was pushed to the background by the outbreak of the Second World War and the political developments in the country. The programme of abolition of intermediaries, that is, of the zamindar and his sub-infeudatories, could again be taken up in earnest only after independence.

5

Tenancy Laws and Land Reforms in India

The Pre-Independence Period

In the period following the adoption of the Permanent Settlement in Bengal, Bihar and Orissa, a good number of old zamindars lost their lands due to their inability to meet revenue demand on time. Their estates were sold by auction to the highest bidders. This new class of zamindars had little interest in the proper management of their estates and often leased out a major portion of their estates to tenure-holders who were lower in the rural social hierarchy. Many of the bigger zamindars, in fact, became urban-dwellers siphoning off the rental surplus from the rural areas for extravagant 'European style' living in the towns and cities. A good number took to modern professions like legal practice without, however, relinquishing their rights on zamindari estates. The cultivators came to be over-awed by the intermediate tenure-holders and the zamindar's local agents. For many years after the introduction of the Permanent Settlement in 1793 there were practically no provisions to protect tenants from eviction, enhancement of rent or personal harassment for arrears of rent.[1] As the limits of cultivation were being reached and prices of agricultural crops were moving up, the demand for acquisition of both intermediate rights and plots for cultivation remained quite brisk. Rent levels r[illegible] but generally the rise was moderate, being much lower than the rise in prices of agricultural produce. This, however, brought about undesirable consequences in the form of sub-leasing of the tenant-farmer's land to sub-tenants—in some places a whole series of sub-tenants. As a result the actual management of cultivation devolved upon the most resourceless sections of people in the rural areas who were usually either tenants-at-will or crop-sharing tenants, both of whom were absolutely insecure against eviction.

Lord Cornwallis and his advisers had hoped that the tenants' rights to security of tenure and reasonable fixity of rent would be respected by the zamindar in his own interest. Besides, the protection of the law courts, they thought, would be there to see that rent levels, sanctioned by usage, would

1. Mr Harington's proposals (1806) for an explicit declaration of the rights of *khudkast* ryots were regarded by the authorities as unwise, since such regulations might hinder the development of the country's resources.

be adhered to by zamindars and other intermediaries between the State and the ryot. In practice, usage was flouted and the law-courts generally remained beyond the reach of the ordinary ryot. Hence, certain rights which ryots, or at least *khudkast* ryots, had enjoyed for generations were on the verge of being extinguished. It was to reassert such traditional rights by legal proclamation that the Rent Act (Act X) of 1859 was passed.[2]

Under the Rent Act of 1859 all tenants who had cultivated the same plot of land for 12 years without break were treated to have acquired 'occupancy' rights. Such 'occupancy' tenants were not liable to eviction so long as they were not in arrears of rent. The Act also laid down that those tenants who had paid the same amount of rent for 20 years or more were to be treated as 'permanently settled' tenants with occupancy rights automatically acquired. Enhancement of rent for other occupancy and non-occupancy tenants was also sought to be regulated. By the Revenue Sales Act (Act XI) of the same year the power of the purchaser at a land-auction to enhance tenants' rents was taken away. A few principles were laid down for the guidance of law courts concerned with rent suits. Rent could be enhanced only (*a*) if it could be proved that the existing rent was below the rent of similarly situated land in the same village or (*b*) if the value of produce or the productive capacity of land had gone up for reasons other than the ryot's own effort and expense. Generally it was accepted that the money rent should be allowed to increase, if so demanded, in the same proportion as the money value of the produce from the land.

The acquisition of 'occupancy rights' by ryots was often checked by zamindars and other tenure-holders by shifting tenants from one plot to another so that they could not claim to have cultivated the same plot for 12 years at a stretch. Various subterfuges were also resorted to in order to settle new tenants on land with enhanced rent. With a view to countering such moves, the Bengal Tenancy Act (Act VIII) of 1885 was passed. This Act sought to confer the right of occupancy on any tenant who had cultivated land (not necessarily the same plot) in a village for 12 years. This led to a marked increase in the number of ryots with occupancy rights. The provisions relating to enhancement of rent were also modified in favour of the ryot. In the case of a rise in the value of crops produced, rent could be enhanced, but only after one-third of the increment in value was retained for the ryot. Rent could not be enhanced by more than 12.5 per cent at a time and no revision could be asked for before the expiry of fifteen years. However, the occupancy right did not carry with it full rights of sale or gift of land. An amendment to the Act of 1885, enacted in 1928, gave the occupancy ryot the right to transfer his tenancy, but only after payment of

2. At Lord Dalhousie's initiative, an investigation into the laws of distraint (for non-payment of rent) was undertaken in 1854–55. Christian Missionaries settled in Bengal also played a part in changing official opinion about the need for tenancy legislation.

20 per cent of the consideration money as transfer fee to the landlord or five times the annual rental whichever was greater. The landlord also had the right of pre-emption over the land whose tenancy was sought to be transferred. Ten years later, in 1938, a popularly elected Ministry in Bengal abolished the transfer fee and the right of pre-emption. Occupancy rights could now be freely transferred after giving notice of the transaction to the landlord. The proportion of non-occupancy tenants in Bengal during the late 1930s was estimated as 1 in 500. For such inferior tenants there was provision only for six months' notice in case of ejection. For share-croppers there was neither recognition nor protection. In Bengal, crop-sharing tenants were paying about Rs. 25 per acre in kind to their landlords, while occupancy tenants were paying only an average of Rs. 3.3 per acre.[3]

Measures to check the arbitrary eviction of rightful tenants and unwarranted rent enhancement were also enacted in other British Indian provinces on more or less similar lines. However, there were differences in the conditions for acquiring occupancy rights. In Central Provinces, for example, such rights had to be acquired by purchase on payment of 2½ times the annual rental. In Punjab, they could be claimed only on historical grounds. But the creation of a superior category of occupancy ryots did not substantially improve agrarian relations. A class of functionless proprietors of land continued in existence. It should not be thought, however, that all such proprietors were in control of vast areas of land or that all of them were lavishly rich. The landlord estates also got partitioned among co-sharers according to prevailing laws of inheritance, with the result that after a few generations, the rental income accruing to a co-sharer could be quite negligible. The primary objection to such landlordism was not that the landlords in general enjoyed a much higher income than most of their tenants, but that they stood in the way of tenants feeling a sense of ownership over the land they held. Without such a sense of ownership the tenant's interest in his land was bound to be limited, specially if the tenancy was of a short duration. Moreover, the landlords' incomes did not represent the return to any economic function, since very few of them participated in the actual management of the cultivated land.

The Government of the province of Bengal set up in 1938 a Land Revenue Commission under the chairmanship of Sir Francis Floud to examine the issues of land revenue in the context of the Permanent Settlement. In their Report, submitted in 1940, the majority of the Commission recommended that the zamindari system and Permanent Settlement should be replaced by a Ryotwari system so that tenants could hold land directly under the State. This would, in their opinion, open the way for the participation of the State in schemes of agricultural improvement. The zamindari system, they held, had become out-dated, not so much because the ryots were rack-

3. Nanavati, M.B. and Aniaria. J.J., *op. cit.*, p. 53.

rented (in fact rent per acre was lower in permanently settled areas than in areas that were temporarily settled), but because it served no social purpose and failed to contribute to the development of improved agricultural practices. In their opinion, not only zamindars, but all tenure-holders, intercepting portions of the rent paid by tenants, ought to be weeded out. However, these intermediary interests were to be acquired by the State only after payment of suitable compensation, which might be between 10 and 15 times the annual rental less cost of collection. The compensation was preferably to be paid in cash or, failing that, in bonds redeemable after 60 years. Intermediate rights on fisheries and land containing minerals were also to be acquired by the State on payment of compensation.

A few members of the Commission, however, disputed the view of the majority that the existing system of land revenue settlement was primarily responsible for the deterioration of agricultural conditions in Bengal. There were other more important causes. In their opinion it would be rash for the State to acquire all intermediary interests, since it would involve a heavy compensation payment, whereas the collection of rent by the State from a very large number of tenants would create formidable problems. They could see little benefit from the abolition of landlordism and were afraid that such a measure would injure the middle classes in rural society.

A number of measures for conferring greater rights on tenant cultivators were adopted in other Indian Provinces also during 1937–39. Mention may be made of the Bihar Tenancy Act (1938), the Central Provinces Tenancy Act (1938), the United Provinces Tenancy Act (1939) and the Bombay Tenancy Act (1939). All of these Acts led to the emergence of a privileged category of ryots with their rents reasonably stable, but they generally failed to protect the interests of the weakest sections of cultivators who continued to hold their lands under conditions of extreme insecurity, both in respect of occupation and rent levels.

Land Reforms After Independence

It was only after the attainment of Independence in 1947, and in the context of the planned development of agriculture in India, that more comprehensive measures of land reforms came to be introduced. At the time of Independence nearly 40 per cent of the cultivated area in the country was under the proprietorship of different types of landlords or intermediate interests. The primary object of land reforms was the abolition, as far as practicable, of all such intermediaries and establishment of a direct relation between the State and the cultivator. In those cases where such intermediate interests could not be immediately abolished, the aim of land reforms was to guarantee security of possession to the tenant-cultivator and to fix the rent payable by him at a fair and equitable level. In addition, it was also

to be ensured that the ownership of land did not remain too unequal and some land belonging to bigger owners (who could not possibly cultivate the whole of it with family labour) was made available to smaller owners and landless agricultural labourers eager to be settled on land. The proposed land reform measures sometimes also included schemes for consolidation of holdings so that scattered plots belonging to the same cultivator could be exchanged with plots belonging to others and all cultivators could thus operate on larger and more compact plots of land. In some cases, land reform measures were intended to encourage farmers to combine their plots for 'joint co-operative farming' for better results.

Among the States of India, Uttar Pradesh (U.P.) led the way by enacting the U.P. Zamindari Abolition and Land Reforms Act in 1950. Bihar adopted its Land Reforms Act in 1950 and Orissa in 1951. The West Bengal Estates Acquisition Act, passed in 1953, led to the abolition of intermediary interests in land and the West Bengal Land Reforms Act of 1955 imposed for the first time upper limits ('ceilings') on the holding of agricultural land. Laws on similar lines were placed on the statute-book in most Indian States by 1960 and further amendments were introduced in later years. Along with the State acquisition of landlord interests, there were measures for reduction of rent; the normal level of rent was not to exceed 1/5th of the value of gross produce. Laws for the acquisition of 'ceiling-surplus' land and distribution of such land among small farmers and landless rural labourers were also enacted in almost all the States throughout the period 1950–75, with subsequent amendments here and there. Put briefly, the subject of land reforms came to acquire a paramount importance in the planned economy of India, both because land reforms were expected to lead to better agricultural practices and because social justice demanded that a scarce natural resource like agricultural land should be more equitably distributed.

The erstwhile landlords, though deprived of their rent-receiving rights by the land reform measures, were permitted to retain a certain amount of land for cultivation under personal supervision. This sometimes led to the unfortunate consequence that land, already settled with tenants, was resumed by its owner for so-called 'personal' cultivation, the former tenant being shown as a farm labourer helping in the work of cultivation. The rent-receiving rights of former landlords were acquired by the State with compensation payments, the quantum of such compensation being somewhat different in different States. It was usual for the scale of compensation to vary inversely with the annual rental incomes of the estates. In West Bengal, for example, the large zamindari estates were acquired witha compensation of 2 times their annual rental incomes, whereas in the case of very small estates, the compensation could go up to 20 times the annual income. In a few States, it was provided that tenants could acquire ownership right by making payments towards the value of land by instalments.

Usually, however, the compensation was paid, not in cash, but by the issue of interest-yielding bonds redeemable after a fixed period.

In several States (such as West Bengal) tenants with occupancy rights were already protected against eviction, had full rights of sale and transfer and were as good as owners. They now came to be treated as tenants of the State, liable to pay rent only to the State, and not to any individual landlord. But tenants who were not earlier enjoying such rights were also gradually given the same privileges in the land reform measures adopted after Independence. However, the very small tenants probably got thrown out in many instances, as their landlords resumed their land for 'personal' cultivation. Tenancy reform thus proved to be of no benefit for these 'downgraded' tenants.

The laws fixing 'ceilings' on the amount of land permitted to be held by an individual or family have usually taken the desirable upper limit at three times the 'family holding', the latter being defined as a holding that can yield an annual income of Rs. 1200 to a cultivating family. This ceiling has naturally varied from one State to another and different 'ceilings' have been fixed for irrigated (wet) and non-irrigated (dry) lands. The ceiling laws in most States had left loopholes which permitted large owners to transfer their land to other family-members, friends, relatives or even totally fictitious parties. As a result, the amount of land declared as surplus was woefully small, much smaller than what might be expected from the available statistics relating to distribution of land ownership in the country. Moreover, the acquisition of surplus land from their owners involved a financial burden which few State governments were in a position to bear. The procedure for acquisition was also cumbersome. Even when the surplus land was acquired by the State, problems arose regarding the mode of utilisation of such land; it had to be decided whether such land was to be sold to the highest bidder or distributed on other considerations. In practice, much of this land remained as government property, temporarily leased out for cultivation for one or more crop seasons. The benefits that might be expected from a wider diffusion of ownership rights on agricultural property have yet to be fully realized.[4] The implementation of 'ceiling' legislation appears to have been thwarted by vested interests working both from inside the administration and outside, and this may be the explanation for the very uneven distribution of ownership over agricultural land that is still revealed in our quinquennial Agricultural Censuses.

The post-Independence period also saw legislative enactments in several States for consolidation of holdings. Punjab, Haryana and Uttar Pradesh have successfully implemented their schemes of consolidation of agricultural

4. In March 1980, out of about 15.74 lakh hectares of land declared as 'surplus over ceiling' in different States, acquisition was complete in respect of 9.56 lakh hectares. Of this nearly 6.79 lakh hectares had been distributed. The aggregate amount of agricultural land (including fallow lands) in the country is roughly 1630 lakh hectares.

holdings, while other States have generally lagged behind. One of the major difficulties involved in implementing a land consolidation scheme relates to the valuation of holdings, since a cultivator will not be willing to part with his holding unless he gets in exchange another plot of the same quality and value. These and other difficulties have worked against the speedy implementation of even those consolidation schemes that have been proposed. By 1980, only about 25 per cent of all consolidable holdings in the country (4.5 crore hectares out of about 16 crore) was actually consolidated. In the States of Eastern India consolidation of holdings has assumed great importance because of the existence of a very large number of small farms with fragmented holdings. Yet no serious effort to implement schemes of land consolidation has been evident in this region (except in Orissa in recent years) even in the post-Independence period. It is also to be remembered that the benefits from consolidation can be reaped only when subsequent sub-division and fragmentation of land can be checked. Legislative measures for preventing fresh fragmentation of holdings after consolidation have been recommended by the Planning Commission.[5] Land reforms being a State subject, such measures will have to be initiated and implemented by the States according to local needs and subject to local constraints.

For effectively implementing schemes of land reform and to minimise disputes regarding titles to land, it is absolutely essential to have a complete record of rights. For historical reasons, such records are more comprehensive in the former ryotwari areas than in zamindari areas, particularly those zamindaris that were permanently settled. Work has been undertaken in the post-Independence period to compile land records correctly showing the ownership of land, the names of tenants (if any) and the conditions of tenancy. In the absence of such records it is difficult to check the growth of 'oral' tenancies, where the tenants cannot claim the rights they are legally entitled to enjoy. Crop-sharing tenants (*bargadars* and *bataidars*) have generally been denied such rights because their conditions of tenancy were nowhere explicitly recorded. West Bengal has almost completed a scheme,[6] of recording of *bargadars*' rights, though nearly 30 per cent of such crop-sharers have not come forward to get their rights recorded. The ascertainment of the exact nature of rights in land in a country of over 16 crore agricultural operators (inclusive of nearly 6 crore agricultural labourers, some of whom are in fact unrecorded tenants) is certainly a formidable task. The progress in the direction of preparation and revision of land records has been slow due to paucity of funds and organisational deficiencies. Slow progress in this respect has been at least partly responsible for the inadequate flow of farm credit to small and resourceless farmers.

5. Planning Commission—Sixth Five Year Plan 1980–85, p. 116.
6. The scheme is usually referred to as 'Operation Barga'.

Provision of home-stead land on a secure basis to the landless rural workers and artisans has also been one of the declared objectives of land re-distribution policy in India. This was made a part of the Minimum Needs Programme (1971), the Twenty Points Programme (1975) as well as the Revised Twenty Points Programme (1982). Nearly 50 per cent of the total number of eligible households were reported to have been allotted house-building sites in the rural areas of different States[7] by 1979–80.

7. Planning Commission, *Sixth Five Year Plan*, 1980–85, p. 225.

6

Economic Transition in India in the Nineteenth Century

In the fifteenth and sixteenth centuries geographical explorations and the gradual improvement in oceanic transport brought India into closer touch with the countries of Western Europe. Before this Indian commerce was largely conducted through the trading centres of the Middle and Far East. Moreover, owing to the prevailing costs and risks of communication, only luxury articles having a large value in a small bulk were exchanged in trade. The discovery by Portuguese sailors of the sea-route to India *via* the cape of Good Hope diverted the direction of Indian trade by making possible larger shipments to Portugal, Holland, Denmark, France and England. Traders' groups were formed in all these countries to specialise in trade with India and countries lying further east. The value of this trade was appreciated also by the Indian rulers of the period who gave various concessions to the first European merchants who set foot on Indian soil. Rivalry for these concessions and later rivalry for obtaining political power at the expense of the disintegrating native political authority were a marked feature of European trading activities in the eighteenth and nineteenth centuries. In this intense rivalry the British East India Company ultimately emerged victorious and succeeded in winning an extensive empire for the British Crown. Important changes in the structure of commerce were taking place throughout this period with attendant changes in the nature and organisation of both agricultural and industrial production, in the means of transport and communication, and in social and political institutions and ideas. This entire set of changes has been often described as the Economic Transition in India.[1]

In the early years of commercial relations between India and Western Europe, various manufactured products of India were purchased by European merchants for sale in Europe. But since the market for European products in India was extremely limited, Indian exports had to be paid for by the shipment of precious metals from Europe to India. As the British merchants started acquiring a larger and larger share in Indo-European trade they had to face a mounting criticism in their own country that they were in effect destroying the manufacturing industries of Britain

1. Sir Theodore Morison, *Economic Transition in India* (London, 1914).

and denuding England of the precious metals.[2] Severe restrictions were put on the annual export of bullion from England as well as on the sale of articles of Indian origin in the English market.[3] The difficulty caused by the restrictions on bullion export was overcome when, after the acquisition of Diwani rights in 1765, territorial revenues began to pour into the East India Company's coffers. A substantial part of these territorial revenues was used as the 'investment' to purchase articles of trade from India; a certain portion of revenue was even used to buy goods for a similar purpose in China and the Far East. The character of articles entering in trade underwent a sea-change as manufactured articles of Indian origin were gradually ousted from European markets. Instead, industrial raw materials and other tropical commodities, such as cotton, indigo, sugar, tea, coffee and foodgrains, began to figure prominently in Indian exports. After 1813 the British Government's policy was to encourage Europeans to go and settle in India in order to develop large-scale, progressive agriculture, although this policy was successful only to a limited extent.

The external commerce of India received a further impetus as England, after having established her industrial and military supremacy, found it fit to abandon the principles of Mercantilism and adopt instead policies of duty-free and unrestricted trade. The various restrictions on foreign shipping and excessively high duties on goods carried by foreign ships were finally given up in England in 1853. In the quinquennium 1854–1859 imports into India (Rs. 15.37 crores) were nearly four times higher than during 1834–1839 (Rs. 4.97 crores). Exports rose during the same period from Rs. 11 crores to Rs. 22.2 crores.

The replacement of sailing ships by steamships, occurring after 1840, was a further influence favouring expansion of India's trade with the rest of the world. Countries other than England had also begun to expand. Originally it was the West European countries led by Germany, which came into closer trading relation with India. Towards the end of the nineteenth century the United States and Japan also appeared on the scene selling their finished products in India. After 1869 the sea route between India and Europe was considerably shortened by the opening of the Suez Canal. The laying down of submarine cables and spread of international postal facilities considerably helped the processes of trade.

Along with changes in the conditions of external commerce, the internal market of the country was also being opened up. Duties on internal transit of goods, which stood in the way of the free flow of goods from one part of the country to another, were rapidly abolished after 1836. The

2. Under the influence of the body of thought known as Mercantilism, people in this period were apt to believe that the precious metals constituted the real wealth of the country.

3. The restrictions were at their severest during the critical years 1798–1812 when England was waging a life-and-death war with Napoleon's France.

railways and road-building programmes undertaken since the middle of the 19th century created a veritable revolution in the means of transport.[4] Difficulties about means of payment were solved after 1835 when a uniform Rupee coinage was legalised throughout the country. By the third quarter of the nineteenth century free trade principles were so much extolled as to lead to the abolition of almost all import duties by gradual steps after 1875. Export duties were similarly taken off in that year except a 3 per cent duty on exports of oilseeds, rice, indigo and lac. In 1880 all export duties were abolished except that on rice. Import duties were totally abolished in 1882.

The outcome of all these factors was to increase rapidly the volume of external trade. During the quinquennium 1864–65 to 1868–69 the average annual value of private merchandise trade (imports and exports) was about Rs. 87.5 crores. This rose in 1913–14 to Rs. 427 crores. As already pointed out, the country's exports now began increasingly to take the form of agricultural or mineral raw materials and foodgrains, while the imports came to consist of manufactured goods.

A direct consequence of this change in the nature of India's foreign commerce was the decline in the demand for hand-made products formerly turned out for both domestic and foreign consumption by India's weavers, metal fabricators and millions of other craftsmen. Since these people were mostly conservative, poor, caste-ridden and illiterate they could not organise on their own initiative to meet the challenge of the imported manufactures by introducing more modern methods of industrial production. The government of the day was completely indifferent to the suffering of these unfortunate people. As a consequence, the only way for them to survive was to take to agriculture, either by claiming a share of their patrimony, or by joining the ranks of landless rural labour. This large-scale abandonment of their traditional industrial occupations by Indian craftsmen and their joining the ranks of agriculturists has been described as the "de-industrialisation" of the Indian people, which surprisingly occurred at a time when most European countries and Japan were creating conditions for the expansion of industrial employment for their own people. Such a sudden swelling in the number of people in agricultural occupations led to an enhancement in rentals and land values, caused sub-division and fragmentation of landed property and gave rise to the problems of uneconomic land holdings and unproductive rural debts.

Some changes in the organisation of domestic production came to be dependent on imports of improved equipments from the industrially developed countries. Such imports, however, were extremely restricted in the first instance because of the inability or unwillingness of the bulk of the

4. The railways were so constructed that principal ports like Calcutta or Bombay were linked up with the interior, thus facilitating the movement of goods into and out of the country.

population to have recourse to new techniques of production. The new techniques, it must also be remembered, were generally labour-saving and whenever they were introduced the problems of unemployment and under-employment were intensified. There was no agency to look after the proper rehabilitation of the technologically unemployed population who also had to fall back as a last resort on agricultural occupations. To a certain extent, however, the introduction of public works like road and railway construction and the rise of modern industries in the second half of the nineteenth century must have created new opportunities for the more enterprising section of the population who came forward to take up jobs in these growing sectors by defying in large measure the rules of caste.

The creation of gradually widening opportunities for the sale of bulky articles abroad led also to significant changes in the pattern of agricultural production. Whereas formerly the farmers produced to meet only the needs of their family-members and their share of such obligations as the cost of upkeep of village menials and of State revenues, now they began increasingly to produce for cash sales.[5] Thus 'subsistence' farming began to give way to 'commercial agriculture' and the traditional isolation of the village was ended. The 'commercialisation of agriculture' led to some amount of regional specialisation. Farmers in different parts of the country, instead of growing all the crops needed for their consumption, began to produce one or two cash crops which were suited to the regions where they lived and which could be disposed of at the highest profit. With the cash thus earned they could buy their requirements, including their food requirements, from the market. Thus the use of cash for various purposes began to penetrate the villages. Instead of a simple exchange of goods, resorted to only when necessary, a regular 'cash nexus' came to be established between the village and the outside world. A number of new crops like tea, coffee, jute and indigo came to be introduced mainly with an eye to the export market. Crops which were not hitherto grown in India, such as potatoes, also began to be taken up eagerly by Indian cultivators because of their commercial value.

The transition from subsistence farming to commercialised agriculture necessarily involved the coming into existence of a group of middlemen

5. Percentage of exports to total production for principal Indian crops:

Crop	*1913 14 average*
Tea	96
Linseed	73
Raw Cotton	56
Raw Jute	51
Indigo	40
Groundnuts	35
Wheat	14

See Sapre, B.G., *Essentials of Indian Economics*, p. 46.

traders specialising in the marketing of the cash crops. The indigenous middleman became a link between the petty cultivators in the villages and the export agencies with their world-wide connections. The prices of Indian crops came to depend on world prices. A general upward movement in the prices of cash crops was to be expected as world demand, determined largely by the level of prosperity in the industrially developed countries, began increasingly to turn towards India.

The requirements of export trade brought into existence a number of minor industries such as cotton-ginning and pressing factories, jute presses, mills for polishing of rice, tanneries for leather and so on. Extraction of minerals other than coal developed mainly in response to the demand coming from abroad. Certain forest products like lac began to be exported in larger and larger quantities and systematic cultivation of important forest products was a natural consequence of such development.

With the expansion of trade and production came the need for the expansion of financing facilities. Agency houses which took the initial responsibility of financing external and internal commerce and early industrial ventures, were supplemented by banks, both European and Indian. Through these agencies a considerable amount of foreign capital came to be employed in Indian commercial and industrial ventures. In addition, the British Railway companies invested capital in India and the Government of India obtained funds by borrowing abroad for the construction of railway and irrigation works. The economic transition in India in the nineteenth century depended to a considerable extent on the inflow of foreign capital as well as foreign managerial expertise through the Managing Agency Houses which were a peculiar outcome of Indo-British economic relations during this period.

The effect of the great changes in transport and trading opportunities was to make villages more and more dependent on the outside world for their economic needs. The ancient village community in India has often been compared with a self-sufficient Republic with the minimum of contact with the rest of the country, not to speak of the other nations of the world. Each village could look after all its regular economic needs because each had a complement of local rural artisans who served the villagers and received a customary remuneration in the form of a share in the agricultural crops or a portion of the cultivable land of the village. Administratively the village was run by a headman assisted by an accountant and watch-and-ward staff. In some villages, in addition to (or instead of) a single headman, there would be a council of village elders called a Panchayat. The exact administrative structure varied from one part of the country to another and also depended on the size and wealth of the village. On top of this there would perhaps be a remote landlord whose function would be to collect revenues for the State, preserve law and order in the area under

his charge and contribute troops to the government of the day during times of war.

This largely autonomous character of the village was seriously impugned when the British authorities established a highly centralised revenue and judicial administration in the different Presidencies. As Sir Theodore Morison observed, the new system by taking charge of the functions previously discharged by the village Panchayat weakened the springs of local autonomy, and the Local District Boards, established later, have probably proved no substitute for the narrower but more vigorous self-government of the village.[6] The village artisans who used to receive a customary remuneration, irrespective of the work done in a particular year, were put more and more on a contractual basis, being paid according to the amount of work actually done for a particular consumer. The inroad of imported consumer goods in many cases reduced the villagers' demand for the traditional services of the artisans and the latter were forced to swell the ranks of general unskilled labourers, Wherever possible the redundant labourers turned their back on the villages and took up employment in the newly developing factories, mines and plantations. The extent of such emigration from the village of course varied with the proximity of the village to railways or to the growing urban centres.

The factory system of production, by bringing together large masses of workers belonging to different castes under a single roof, uprooted deeply ingrained habits of thought and work. The railways compelled people of high and low castes to rub shoulders with one another when travelling in the same compartment. Thus the economic transition released forces tending to modify the social structure, although it will not be correct to say that all traces of traditional caste prejudices against certain occupational groups have even today been totally wiped out.

The old Indian village was the home of large joint families in which all near kinsmen lived in the same house and ate in the same kitchen. Usually it was the oldest living male member of this extended family who would manage the family property and look after all important domestic affairs. As the villages began to be linked up with urban centres, some members of the family found it lucrative to migrate to towns and take up urban occupations. The lack of accommodation in urban areas and other factors made it impossible for the entire family to live under one roof and brought about the dismemberment of the extended family. While some of the advantages of joint living, such as greater security, were thus lost, the 'nuclear' family, adjusted to conditions of urban living, probably encouraged regular work habits and thrift on the part of the heads of such families. In these and other ways the economic 'transition' brought in its wake marked changes in the pre-existing social structure. The forces producing these

6. Sir T. Morison, *op. cit.*, p. 38.

changes have been at work throughout the period of our study and have not ceased to operate even to this day.

Commercialisation of Agriculture

Commercialisation of agriculture, that is, production of crops for market sales rather than for family uses, started in the early years of the nineteenth century and gained in momentum after the opening up of the country by roads and railways in the middle of the century. The reasons for the transition of agriculture from a basis of family self-sufficiency to a basis of commercial gains are not far to seek. In the first place, the need for some cash earnings had arisen in the village owing to the introduction of cash assessments in the system of revenue collection as well as to the greater use of money for credit purposes. Secondly, the growing commercial classes flocked to the villages to secure crops for trade and their insistence led the villager to plant cash crops, particularly when they were indebted to the traders for their occasional ceremonial and other expenses. In course of time the shrewd farmer himself began to appreciate the importance of cash crops. He found it easier in many cases to meet his subsistence needs by selling cash crops instead of growing food on his own land. The relative prices of cash crops and food crops began to determine more and more the uses to which his land would be put. The growth of cash crops was also encouraged by the Government of India's agricultural policy which remained geared throughout the nineteenth century, and even later, to meeting the raw material requirements of British industry rather than to any purely domestic ends. As the farmer's requirements of cash were more or less determined by the amount of land revenue and other contractual demands, it would be natural for the farmer to vary his output of cash crops inversely with the market price of such crops. Statistical evidence in recent years indicates, however, that farmers' demand for cash incomes has now lost the inelasticity it had in earlier periods.

With the spread of commercialisation, agricultural production began to get localised. It now became possible for a particular area to grow simply one variety of commercial crop and trade it for its food and other requirements. It is obvious that such specialisation was dependent on the extensive network of communications that was being built up in different parts of the country.

The export of agricultural products was sometimes attributed to the exploitation of the farmer through unduly burdensome land taxes. The late Romesh Chandra Dutt believed that India's comparative advantage lay in the production of cotton textiles and not in agricultural raw materials. The British Government, by artificially restricting the inflow of cotton textiles into England, was forcing Indian trade into channels which were not justified by India's natural advantages. The farmers, he believed, were

being forced by extremely severe revenue demands to sell more of their crops than they would themselves consider desirable.

It is perhaps true that the relatively small farmers could derive very little benefit from the commercialisation of agriculture. As agriculture became the hand-maiden of trade, the commercial interests began to appropriate the larger share of whatever gains accrued from the country's agricultural exports. The farmer, in fact, was made to bear all the unfavourable consequences of the instability to which the world trading system in agricultural products was usually subject. In a period of falling prices, the farm-door prices would be cut down promptly. But the benefits of rising prices would be slow to reach the farmer even when they reached him at all.

One of the early events that sparked off a boom in agricultural trading was the Civil War (1861–64) in the United States of America. For some years before the Civil War broke out Lancashire cotton manufacturers who derived the bulk of their supplies of raw cotton from the USA had become apprehensive of their excessive dependence on a single source of supply. They had initiated, through the Secretary of State for India, a number of measures that were calculated to increase the production of good, clean cotton in India. But these measures succeeded only to a limited extent. As the USA plunged into a Civil War, British purchase of raw cotton in India suddenly went up. Not only exports of cotton but of several other raw materials like jute and oilseeds also expanded during the 1860s.

It is still a matter of debate whether the expansion of commercial agriculture in India has taken place at the expense of foodcrops. While this may have occurred in some regions of the country, the overall picture is that the area under commercial crops has been obtained mainly by extending the acreage under cultivation. In 1950–51 only about 20 per cent of the gross cropped area was under the recognised commercial crops, *viz.*, cotton, jute, sugar-cane and the various oilseeds. Commercialisation of agriculture, however, has spread also to the foodgrains since an increasing proportion of the total production of all foodgrains nowadays passes through the market instead of being consumed on the farm

De-Industrialisation: The Decline of Handicrafts

For the larger part of the eighteenth century Indian cotton textiles enjoyed a cost advantage over corresponding British (or other European) manufactures.[7] Metallic industries in India were also as efficient, from the technical point of view, as similar industries in Western Europe, except for

7. *Cf.* H.H. Wilson: "..the cotton and silk goods of India ..could be sold for a profit in the British market at a price from 50 to 60 per cent lower than those fabricated in England." (*History of India*, Vol. I, p. 538).

some special products. India could then provide the rest of the world with a variety of hand-made artistic wares, while she needed very few manufactured articles from abroad.

Three kinds of industry existed in India—the *rural cottage industry* usually providing the day-to-day requirements of the agriculturists in the village, the *urban domestic industry* turning out various products for the use of townsfolk and carried on by family members, possibly in a room in the house where the family lived and, finally, the *small urban factory* producing more sophisticated products, engaging some hired labourers and generally carrying specialization further than in domestic industry. Urban industry of all types depended for its prosperity on the patronage of the king and his entourage. In the Mughal period the urban areas resembled a military camp more than a settled commercial or industrial city with which nowadays we are familiar.

The East India Company found it profitable to carry on export trade in Indian manufactures with England and Western Europe. Although, beginning from 1700, restrictions were imposed in England on the import of silk goods from India to protect English silk weavers, such restrictions did not initially affect the sales of Indian handicrafts. Silk goods from Bengal continued to be exported to France and other European countries, although not to England. But political disintegration in India, economic exploitation of artisans by foreign merchants and their Indian agents and, finally, the introduction of mechanical inventions and application of steam power to British cotton textile industries which greatly increased their productivity gradually brought about the decline of the handicrafts in India.

A very large part of the domestic demand for handicraft products always came from the royal court. With the decline in royal power, such demand naturally dwindled. *Karkhanas* which were set up in different parts of the country to provide the requirements of the royal court and the urban nobility had to be closed down when the establishment of British rule in India dislodged the local rulers and their camp-followers.

As the power of the native rulers declined, British merchants and their commission agents began to exercise illegitimate pressure on craftsmen for delivery of goods to them on a priority basis at unduly low prices. Craftsmen were forced to sign agreements for delivery which, under more normal conditions, they could hardly be induced to do. The Directors of the East India Company issued ineffective warnings from time to time against such inconsiderate exploitation of the manufacturing classes. Some of them could realise that it was not a wise policy to "kill the goose that lays the golden eggs". But the men on the spot in India wanted to make quick money and return home to live like Eastern Nabobs ever after. They paid little heed to the importunities of their masters, at least as long as their salaries were not substantially improved under Lord Cornwallis's regime towards the end of the eighteenth century. Due to the exploitation of the merchants

Indian craftsmen were forced to abandon their crafts in some cases or flee to regions where more sympathetic policies were still pursued.

In the last quarter of the eighteenth century application of steam power to industrial processes became possible in England. A series of inventions occurred in the British cotton textile industry which greatly increased the speed of production of cotton yarn and piecegoods and considerably reduced their cost of production. Having by that time consolidated their political position in India the British manufacturing interests could easily take steps to expand their market in this colony. Instead of helping India to acquire the new techniques of manufacturing, her rulers decreed that India, in spite of her immense reservoir of manufacturing skill, should henceforth become a grower of raw produce to be turned into manufactured goods in England. Unrestricted competition from British manufacturers, coupled with crippling restrictions on domestic commerce, was responsible for speeding up the decline of Indian handicrafts in the early years of the nineteenth century.

The establishment of British rule in India led to many changes in the mode of living of the upper classes in India. The new middle class, a product of English education, imbibed the tastes of the English gentry discarding the country's traditional style of living. The demand for many varieties of domestic craft products declined in consequence, while imports from England increased.

The handicrafts, however, could not be completely wiped out. In the rural areas, largely because of widespread poverty, standards of living continued unchanged for a much longer period than in the towns. Village artisans had, therefore, a longer lease of life than their urban counterparts who depended largely on the custom of people in the upper echelons of society. Delay in the opening up of communications in the interior of the country also protected the rural artisans for several generations. In respect of cotton and silk textiles demand for the products of Indian handicrafts was maintained also because many types of coloured textiles are used by the rural people for wearing on ceremonial occasions and the demand for each type is so small in volume that machine production on such a small scale would be uneconomical. Similarly the village iron-monger or woodworker was not eliminated because, demand for small implements continued to come from farmers working on their tiny holdings who naturally also wanted to have repairing services close at hand. These factors explain why handicrafts still survive, particularly in rural areas, and why even to-day, there are more workers in the handicrafts than in the organised industries using more recently developed technological processes.

7

Famines and Famine Relief

Famines occurred in India at more or less regular intervals throughout the period of British rule, the last major disaster being the Bengal Famine of 1943. When British rule was first established, the rulers were ill-prepared to mitigate the effects of famines, even when such famines were caused only by local failure of crops and were not very widespread. As the administrative agencies were improved and particularly as the railway network connected the different parts of the country, large-scale loss of life from starvation could usually be prevented. But even in the Bengal famine of 1943, the death-toll mounted to 1.5 million or more.

The earliest severe famine during the East India Company's reign was the famine in Bengal, Bihar and Orissa in 1770. From 1768 the monsoons were scanty. Prices of foodgrains began to rise[1] until in 1770 there developed a serious shortage of food. The situation was aggravated by the unscrupulous trading in foodgrains indulged in by some British officials and their agents. According to a contemporary estimate about 10 million people perished in this famine, or one-third of the estimated total population of this region. The only measures taken to deal with a calamity of this magnitude were certain relief measures like free kitchens, too few in relation to the need, and a few ineffective regulations on trading in foodgrains. The Company did not even arrange for remission of land revenues after the famine. On the contrary, recovery from the after-effects of the famine was made immensely difficult by a continued increase in the Company's land revenue assessment.

In 1783 there was a widespread famine affecting almost the whole of Northern India, parts of Madras and Bombay and the States of Rajputana. Failure of rains, an invasion of locusts in some parts of the country and wars in the South brought about this calamity. In spite of general suffering, the East India Company continued its revenue demand unmitigated. The only steps taken were to check unscrupulous trading in foodgrains and to encourage some migration from the scarcity-affected areas.

During the years 1790-93 another severe famine engulfed Bombay, Gujarat, the Northern Circars (modern Andhra Pradesh), Orissa and certain districts of Madras. While in Western India relief measures were

1. Fine rice rose in price from 28 seers a Rupee to 3 seers a Rupee. Inferior grains rose from 45 seers to 4? seers a Rupee.

arranged by the Maratha ruler (*Peshwa*), in Madras the East India Company organised some measures of relief. A list of people in need of relief was drawn up by the Company's officials and relief works were started to help such people.

Rains failed again during 1802–04 over an immense tract of land from Uttar Pradesh in the north to Madras in the south. Wars were also a contributory cause of the famine in South and Central India. The Government of Bombay dealt with the famine in its territory by arranging for imports of foodgrains and succeeded in holding down food prices. To provide employment to the people affected by drought conditions both the Governments of Madras and Bombay opened relief works. Revenue remissions were granted in the U.P. and loans ('takavi') were granted to enable farmers to tide over the crisis. In certain areas bounties were provided by the government on foodgrains imported at relatively high prices from other regions of the country.

Madras and the Carnatic were again visited by a severe famine in 1806–07. There were many deaths from starvation as people without work in the fields moved to the cities in search of work and food. The Government of Madras had to import food and sell it to the people at reasonably low prices. But this measure of relief came rather late, after many people had died.

The rains failed in Western India and parts of North-West India in 1812 and scarcity of food continued in this region till 1815. In Gujarat locusts and the rat pest also caused severe destruction of food. In this famine also some people were employed on relief works and paid in kind. But the relief thus provided could not mitigate the hardships caused by an inflexible land revenue policy.

High prices of foodgrains continued to prevail in most parts of North-West India during 1819–20. Madras was affected by scarcity in 1823, Bombay in 1824 and the northern districts of U.P. in 1825–26. In Madras the authorities provided for subsidies on imported foodstuff, but otherwise the general policy was one of non-intervention. Revenue settlement operations which were going on at this time paid little attention to the need for revenue remission in years of exceptional distress.

At the beginning of the 1830s Delhi and the areas adjacent to it were in the grip of acute food scarcity. In Madras the rains failed in 1832 and in the ensuing famine thousands of people lost their lives. The Deccan as a whole suffered from food shortage throughout this period. The people of Delhi and Rajputana were once again severely affected by the failure of the monsoon in 1837. The distress was so great and people's discontent so mounted that food riots became frequent. The Government attempted to maintain a semblance of order with the help of troops, but financial stringency stood in the way of extensive relief measures. A very inadequate works programme was taken up to provide employment to the uprooted

agriculturists. Many people migrated to other areas in search of jobs and food.

In 1854 a famine struck the northern districts of Madras Presidency. Nearly 3 million people were affected. Works were started to provide relief, but these could not help more than a fraction of the people affected. The expenditure on the works programme over a period of nine months amounted to over Rs 12 lakhs.

After the Indian Mutiny agriculture remained unsettled for several years over a large part of the country. The monsoons during 1858–60 were also unfavourable. In 1860 a famine spread over the U.P., Ajmer and the eastern districts of the Punjab and continued well into the next year. There was large-scale unemployment and starvation. During this famine the provincial government displayed considerable initiative in laying down a policy for famine relief This policy won the approval of the Government of India in due course. The idea was to provide employment to able-bodied people at standard wages and to distribute gratuitous relief to old people, women and children who were unable to work. Government also played a major role in the organisation of relief funds with public contributions, including contributions from Britain. After this famine the Government of India appointed an official, Col. Baird Smith, to enquire into the causes of the famine. One of Col. Smith's recommendations was to introduce a permanent settlement - a policy that was later advocated by Romesh Chandra Dutt –to help agriculturists in India.

The next famine of considerable severity occurred in 1866–67 when large tracts in Orissa and Madras were affected. Some of the Western districts of Bengal and Southern Bihar also suffered from food scarcity. The cause was a failure of rains in 1865, but other factors such as loss of non-agricultural employment, excessive land revenue burdens and exports of foodstuffs also played some part. Relief operations were rather half-hearted at first, but as food riots broke out in different areas the government had to sanction larger funds for relief purposes. Towards the end of 1866 the Government of India set up the Orissa Famine Commission under the chairmanship of George Campbell. Theirs was the first detailed report on famines and famine policy by an official Commission in India. The Commission recommended among other measures that plans for public works should be kept ready well in advance of a famine. Another investigation was made about this time regarding the adequacy of famine relief measures in Bihar, the investigation being entrusted to an official, Mr. F.R. Cockerell, by the Government of Bengal. Mr. Cockerell laid emphasis on the importance of accurate statistics relating to population, the state of agriculture and trade, so that timely measures could be taken to relieve suffering in the famine-stricken areas.

The next big famine occurred in 1868–70 over a large area in Western India. About 45 million people were affected by this famine. The distress

was most severe in Rajputana where a severe shortage of fodder was added to the shortage of food. Water was extremely scarce. Many villagers left their homes with their cattle in search of food, water and fodder. A large number of lives were lost because of a cholera epidemic that broke out during the famine.

The next three years were relatively free from shortages. In 1873, however, the rains failed again and by the end of that year Bengal, Bihar and the eastern districts of U.P. were in the grip of a famine. The Governor of Bengal's recommendation to ban food exports and arrange for imports was rejected by the Government of India, since this would amount to government interference with private trade. But relief measures were undertaken quite promptly, the authorities having by this time learnt to sense the approach of a famine in advance. As the famine did not show any sign of abatement even in 1874, the authorities began to appreciate the need for importing food from other parts of the country through official agencies in order to supplement the activities of private traders. By a Resolution dated January 21, 1874, the Government of India appointed an official, Sir Richard Temple, to organise famine relief, specially by arranging for the distribution of food in the interior areas. He introduced a number of very liberal measures which succeeded in preventing starvation deaths, but his action was later criticised as too generous and extravagant. Even during a famine the authorities were rather over-scrupulous about the moral degradation of the people in their charge. Relief measures, they felt, had to be administered without impairing such moral virtues as thrift and self-reliance.

The monsoon in 1875 was late in arriving and scarcity conditions reappeared in Northern Bihar by the end of that year. Madras was affected by the failure of the monsoon in 1876. The conditions worsened in the course of the year and the entire region south of the Vindhyas came to be severely affected. This Deccan famine raged for three consecutive agricultural seasons. The economic distress of the cultivators was due also to the burdensome revenue assessments to which they had been subjected on the basis of the high cotton prices in the 1860s, but which they could no longer bear as cotton prices had begun to decline. Other taxes had also steadily increased since 1860, as the mounting government expenditure called for larger revenues. The Franco-German War in Europe during this period may also have been responsible for the general depression through which Indian agriculture and trade were passing at this time.

The farmers at first tried to make both ends meet by borrowing. The money-lender's trade was thriving as, without his help, the burden of revenue payments and enhanced taxation could not be borne by the farmer. But interest rates were so high in the rural areas that once a farmer ran into a debt, he had a negligible chance to get out of the money-lender's clutches. As the economic distress increased, the farmers' wrath against the money-

lenders exploded in a series of riots. One of the first was a riot that occurred in May 1875 in a village named Supa in Poona district. Later the riots spread to Ahmednagar district as well. The authorities succeeded in suppressing the riots, but failed to take timely measures to avert the impending famine. Although the Government of Madras initiated in 1876 a proposal for the storage of grains through local purchases, this proposal was turned down by the Government of India on the plea that such an action would amount to interference with private trade. It was indeed suggested that high foodgrains prices, by stimulating imports of food, would act as a natural corrective to scarcity.

By the end of 1876 prices of foodgrains had almost trebled and food riots broke out in several parts of the Deccan. Work programmes were started all over the region, but these were generally poorly supervised. A large number of agriculturists migrated to other areas in search of food and fodder. There was considerable loss of life. In 1877 the Government of India deputed Sir Richard Temple, who had considerable experience of famine-relief administration, to make an on-the-spot investigation of conditions in the Deccan. By this time Temple had become more cautious. In his Minutes to the Government of India, he suggested a number of reform measures, most of which were intended to save government expenditure on relief operations. He also found fault with the Government of Madras for paying what he believed to be too high wages to workers engaged on relief-works and favoured greater strictness in admitting people to work under relief schemes.

The famine spread to North India in 1877. Faced with a grave situation the Government of India, under the Viceroy's (Lord Lytton) personal initiative, came out in August 1877 in favour of an overhaul of the existing system of famine relief administration. The provincial Governors were made personally responsible for the administration of famine relief. In the Government of India a Secretary was put in charge of famine administration and direct link was established between him and the personal secretariat of the provincial Governors. The Government of India had so long opposed the Governments of Bombay and Madras regarding the scale of the public works to be set up for relief works. While the latter favoured large-scale construction works of some permanent benefit and under the supervision of the Public Works Department, the former was of the view that small local works supervised by the revenue officers in each district would provide all the relief that was necessary. Large works, it was felt, would impose a recurring financial burden on the government. The new famine relief policy formulated in 1877 resolved this controversy by admitting the need for large public works for effective relief. At the same time the policy statement stressed the need for keeping charitable help to a minimum and re-affirmed the desire of the government to leave private trade unhampered.

Though the famine in the Deccan abated to some extent in 1878, conditions in North-Western India did not improve. An unusually cold winter in 1877-78 added to the distress of the people in this region. Timely rains in 1878, however, brought about some improvement and the scale of relief could be reduced by the end of that year. Local relief works had to be carried on in some parts of Bombay and U.P. even during 1879-80.

On 16th May, 1878, the Government of India set up a nine-member Famine Commission under Sir John Strachey's chairmanship to enquire into all aspects of the famines then raging in different parts of India. There were two Indian members on this Commission, but as the final Report of the Commission was drawn up in the U.K. the Indian members were unable to sign it. The Commission's report was published in 1880. In the first part of the Report the Commission discussed general economic conditions on a region-to-region basis and suggested reforms in the famine relief administration. In the second part were considered long-term measures to protect the country against such ravages. The third part contained a historical survey of Indian famines beginning from the Bengal famine of 1770. The Famine Commission's Report generally endorsed the policies adopted during the famine of 1876-79, but at the same time stressed the importance of toning up the administration. To achieve this end it was recommended that a Famine Commissioner should be appointed to co-ordinate all relief operations in a province. Improvement of statistics was greatly stressed and the appointment of district-level officials to supervise collection of agricultural statistics was recommended. Every province, the Commission felt, should have its own Department of Agriculture. A Director of Agriculture in each province should take charge of all works connected with agricultural statistics, while at the village level the office of the village accountant should be more systematically utilised. To strengthen the famine relief administration on its financial side, the Commission recommended the creation of a special Fund out of revenue surpluses. The proposal for such a fund had initially come from the Viceroy, Lord Northbrooke, in 1874. In the budget statement of 1877–78 the principle was accepted that charges for famine relief should henceforth be looked upon as a recurring charge on the public revenues. In December 1877 a sum of Rs. 1½ crores was proposed to be raised by special taxation to meet the costs of famine relief. During 1879-80, however, the funds earmarked for famine-relief were diverted to meet other expenses, specially the mounting expenses of the Afghan War. The Famine Commission's recommendation was made in this background. From 1881 the Government once again decided to provide a sum of Rs. 1½ crores each year for famine relief and insurance.

After 1880 there was some lull in major outbreaks of famines, but almost every year there were local pockets of scarcity. Adoption of relief measures was now speedier than before. Movement of foodgrains from surplus areas to scarcity-affected areas was facilitated by the extension of

railways.[2] It was, however, private traders who were solely responsible for such food movements and were correspondingly benefited. The Government followed a strict 'hands-off' policy so far as the food trade was concerned.

The Ganjam famine of 1888–89 affecting nearly 1.1 million people and the famines in Ajmer-Merwara and Central Madras during 1891–92, however, put the new famine relief policies to some severe tests. Loss of life could not be entirely prevented. Relief was organised, but either delay occurred in setting up relief-works or the scale of such works was inadequate. Some loopholes in the existing famine relief policy were plugged by reforms introduced in a Government of India Circular of August 1893.

By the end of the 19th century many people had come to believe that famines were a thing of the past. But the failure of the monsoon in 1896 plunged large areas of the country into a very severe famine which raged for the next two years. Thanks to the experience gained in the earlier famines, relief measures could be promptly set in motion. The Government could congratulate itself on the scale of relief provided. Nearly 2.2 million people received some form of relief payment and total expenditure on relief measures exceeded Rs. 7.25 crores. Loss of life could not be entirely prevented, however. Deaths due to undernourishment could not always be distinguished from deaths due to other causes, but mortality rates rose sharply in some provinces like Madhya Pradesh and U.P.

A six-member Famine Commission under Sir J.B. Lyall was constituted in December 1897 to enquire into the effectiveness of the relief policy pursued during this famine and to recommend measures for more effective relief. The Commission submitted its Report in October 1898. The Commission recommended a number of changes in the organisation of famine relief. One of its important findings was that there was little further scope of extension of railways from the point of view of famine relief. Hence, greater emphasis had to be laid in future on protective irrigation works. This vindicated the position of those critics of the Government of India like Romesh Chandra Dutt who were time and again hitting out at the authorities' excessive enthusiasm for railway expansion and their lukewarmness in the matter of extension of irrigation. The critics themselves, however, were not inclined to depart from orthodox criteria in assessing economic benefits. They preferred irrigation works primarily because these were currently yielding a satisfactory rate of return while the railways were a losing concern. The authorities could perhaps plead that in opening up the country by extending the railways they were taking social benefits, rather than profits, into account, but to what extent they were guided purely by this motive and to what extent by the less pure motive of opening up Indian

2. This was one of the recommendations of the Famine Commission of 1878–80. The railway mileage went up from 9,000 in 1880 to 20,000 in 1896.

territory for the benefit of British industry and commerce it is difficult to assess.

The closing years of the nineteenth century saw another famine of considerable severity spread over several provinces. The most distressed areas were Madhya Pradesh, Rajasthan, Southern Punjab and Central Bombay. There were drought conditions throughout this region and it was said that such poor rains were not experienced in India for the previous 200 years. Relief operations were set in motion from October 1899 and had to be carried on in most parts of the affected region until the end of the following year. It was estimated by the Famine Commission which was set up in the wake of this famine that over 1.2 million people lost their lives during this calamity.

The Famine Commission appointed in October 1900 worked under the chairmanship of Sir A.P MacDonnell. It submitted its Report in May 1901. The Commission's Report brought out that the authorities were caught unprepared by this famine as they had not expected another severe famine to follow so fast after the 1896–97 famine. The need for keeping the famine relief administration in high gear all the time was repeatedly stressed in the Commission's Report. Several measures to improve the administrative system in respect of relief works were suggested. One of the points made by the Commission related to the role of private agencies in famine relief. It was urged that, as far as practicable, relief should be administered through non-official agencies. The Commission upheld the importance of a 'moral strategy' in famine relief measures in order to sustain the morale of the people in a famine-affected locality. For long-term improvement the Commission urged greater attention to agricultural education and research, expansion of agencies for rural credit and extension of both irrigation and railway facilities.

The monsoon in 1905 was again adverse. The U.P. and Bombay experienced famine conditions during 1905–06. Relief operations were set in motion in the closing months of 1905 and continued for over a year. The Punjab and Eastern Bengal faced near-famine conditions in 1906 and required relief measures for several months. Next year (1907) Northern Bihar was hit by a severe flood and large-scale unemployment and starvation followed in a wide area. The U.P. was again facing famine conditions in 1907–08 with a failure of the South-West monsoon. Conditions in Madhya Pradesh and Bombay also caused anxiety. In 1908–09 famine conditions were reported from parts of Orissa, Bengal and U.P. Bombay was afflicted by near-famine conditions in 1913–14. Thus, during the opening years of the present century up to the beginning of the First World War, some part or other of the country had to suffer from famine or near famine conditions and called for expenditure on relief.

The years of the First World War also were not free from local scarcities due to failure of the monsoon. Relief works continued to be organised as

and when scarcity conditions appeared. The last year of the War (1918–19) was particularly bad. The south-west monsoon failed over a wide area, particularly in the U.P. and M.P and the loss in crop production due to adverse weather conditions was estimated as no less than 20 million tons. About the same time an influenza epidemic was raging in most parts of the country and the rate of mortality rose sharply. Prompt organisation of relief measures, including the import of 2 lakh tons of Australian wheat on Government account, mitigated the effects of this famine to a great extent. Government also imposed restrictions on the private export of foodstuffs, indicating thereby that the era of unrestricted private trade in foodgrains was coming to an end.

Although local scarcities continued to plague the inhabitants of the country occasionally during the inter-war period, the improvement in transport conditions and in the organisation of relief measures enabled such local shortages to be met from the surpluses of other regions. Starvation deaths became uncommon and the Government could claim that famines had been banished from India. But the Second World War, by clogging the operation of the normal administrative machinery, turned a local shortage in Bengal into a major disaster. In the terrible Bengal famine of 1943 nearly 1.5 million people were estimated to have perished. The Woodhead Commission, appointed in 1944 to enquire into the causes of this famine, pointed out that the local shortage in food supplies could have been made up by imports from outside Bengal if the administrative machinery were geared to the task. The situation was made worse by large-scale hoarding of foodstuffs by private traders. The traders made enormous profits as the price of rice in Bengal rose in April 1943 to five or six times the level prevailing about a year ago

Relief measures were not taken in hand until August 1943, as the Government did not at first like to admit, in the interests of war propaganda, that food was in short supply. Even when a relief organisation was set up it found itself unable to cope with the situation because (*a*) enough funds could not be appropriated for relief, and (*b*) railway transport did not accord the necessary priority to food movements but continued to treat the movement of troops and war materials as more important. Medical and public health measures also proved inadequate and many people died from preventible diseases which broke out in the wake of the famine.

The famine of 1943 was foreshadowed by shortages occurring in the two previous years. The *aman* crop harvested towards the end of 1940 was rather scanty and stocks had to be depleted to maintain consumption levels in 1941. The *aman* crop of 1941 was average, but it did not permit the replenishment of stocks. When Burma was lost by the British in the early months of 1942, those parts of India, such as Cochin and Bombay, which depended for their rice supplies on Burma, turned to the Bengal market. With the cessation of imports from Burma and without an alternative

source of supplies, Bengal's rice market was violently upset. On top of this came the cyclone in certain coastal districts of Bengal and the partial destruction of the *aman* crop of 1942. Movement of surplus food from the interior was greatly hampered by the government's 'denial' policy under which country boats and other transport vehicles were requisitioned by the defence authorities for fear that these might fall into the enemy's hands.

In the early months of 1943 the Government of Bengal tried to grapple with the situation by acquiring surplus food from the farmers' stocks. But, in the absence of an official agency for this purpose, 'procurement' operations had to be entrusted to agents chosen from the trading community. Such procurement was likely to be half-hearted and arrangements for the distribution of the procured surplus were also faulty. Baffled by the situation the Government hastily retreated and declared the abolition of all official controls on food in March 1943. This hastened the disaster. During the period August-October 1943, the famine was in full swing.

The famine of 1943, unlike some of the earlier famines, was characterized by an absolute shortage of food. In earlier periods local crop failures which used to bring about famines in some part or other of the country gave rise to joblessness and loss of incomes, but traders could usually be relied upon to bring in adequate stocks of food at a price. From this point of view the famines in India in this period were "not famines of food, but famines of money".[3] In the Bengal famine of 1943 the trading channels were blocked by transport difficulties, the war psychosis and haphazard official regulations. Yet the extent of food shortage was not very large; the Woodhead Commission calculated that the shortage amounted to only three weeks' normal requirements. Organizational failures at all levels must be blamed for the large-scale loss of life which resulted from this small shortage. It has been aptly described as a 'man-made famine'.

After the attainment of Independence India has experienced serious crop failures on several occasions, but thanks to the timely intervention of the authorities and the greater availability of imports of food on aid terms these occasions have passed off without much loss of human lives. The failure of the monsoons as well as natural calamities like floods and hailstorms are likely to cause damage to crops in some part or other of this vast country almost every year. Relief measures have to be undertaken by the State Governments, almost as a regular measure, to look after the people who are afflicted by such calamities.

Famine Relief Policies

The Government of India hardly had any defined policy regarding the

3. In 1861 Col. Baird Smith described Indian famines as "famines of work than of food". *Report*, para. 175.

administration of famine relief before Lord Lytton's Viceroyalty. When famines occurred, *ad hoc* measures were adopted to relieve suffering, such as opening of free kitchens, granting bounties on imported food and so on. But little attempt was made in an unfavourable season to utilise the man-power temporarily thrown off agricultural work. The effectiveness of relief operations depended very largely on the local administrators as there were no guidelines to direct them regarding their duties on such occasions.

Public works of different types came to be undertaken as a measure of famine relief during the famine in the North-Western Provinces (roughly, present Uttar Pradesh) in 1860–61. Sir George Edmonstone, the Lieutenant-Governor of the province, issued a Circular on 18th July, 1860, calling the attention of his subordinate officials to the impending famine and outlining the steps necessary to relieve suffering. The policy outlined by him received approval from the Government of India later in the year. The essence of the policy was to provide employment to the able-bodied workers and to arrange for free distribution of food to the children, the old and the infirm The wages to be paid to workers on relief were to be kept at the lowest possible level, so that workers would be induced to go back to their regular work as soon as such work could begin. For gratuitous relief funds were to be collected by public subscription, the Government adding a sum equal to the amount collected from the public. The need for remission of land revenue was recognized and *takavi* loans to cultivators were liberalised.

During the Orissa famine of 1865–67 similar policies were followed, but administrative failures were responsible for the very limited scale of relief provided to the sufferers. An innovation in this famine was the system of 'village relief' which provided for gratuitous relief reaching the needy sufferers in their village without requiring them to attend work-houses or relief-centres. This famine also saw an important change in government policy regarding food imports. Instead of leaving such imports to the discretion of private traders, the Government took the initiative and advanced Rs. 20 lakhs from the public exchequer to expedite imports.

In the Rajputana famine of 1868–70 the Government of India showed commendable foresight and by issuing an early circular, dated 2nd September, 1868, directed all officials to take 'prompt and vigorous' measures for relief. In its Resolution of the 24th September, 1868, the Government of India assured work to the able-bodied, subject to the condition that the number of relief works to be started would depend on the availability of supervisory staff. It also extended the scope for government participation in gratuitous relief. Instead of putting in a sum just equal to that raised by public subscription, the Government, it was recognised, might have to spend more in order to fulfil its liability 'for the support of the really helpless'. Various impediments to the free movement of foodgrains were

promised to be removed and liberal assistance was made available to Provincial governments for distribution as advances to agriculturists in the distressed areas.

Further elaboration of the Government of India's famine relief policy was available in the Resolutions adopted in November 1873 and March 1874 when a severe famine was raging in the North-Western provinces. The bare outlines of the policy were almost the same as before, but the officials were reminded of their duty to see that arrangements for the relief of distress were adequate in the areas under their charge. They were warned that they would be held responsible for any starvation deaths occurring in their areas, if such deaths were avoidable by timely action on their part. The Government also carefully laid down the set-up of the Central, District and Sub-divisional Relief Committees which were to be entrusted with the co-ordination of gratuitous relief. Imports of food on Government account were made much more liberally during 1873-74 than during any earlier famine.

Government's famine relief policies were outlined more clearly and definitively in Lord Lytton's Minute of August 12, 1877, during the severe famine in the Deccan. For some months before this a controversy was going on between the Government of Madras and the Government of India regarding the scale of relief to be provided, the nature of public works to be undertaken, the scale of wages to be paid to labourers and the tests to be adopted before admitting a worker for relief employment. This controversy hampered the organisation of relief for the sufferers and when Lord Lytton visited Madras in August 1877 he noted that whereas he had expected to find there a bad system, he actually found a total absence of any system at all. Accordingly he felt the necessity of issuing his famous Minute in which he declared the Government of India's policy to avert death from starvation "by the employment of all means open to the resources of the State and to the exertions of its officers."

The next stage in the evolution of famine relief policy arose with the implementation of the recommendations of the Famine Commission of 1878-80. Its views regarding the nature of public works to be organised during famine relief operations were accepted by the authorities for implementation on subsequent occasions. Though the Commission did not in general approve of government interference with private trading in foodgrains, it recognized that in exceptional circumstances such interference would be justified. Liberal remissions of revenue were advocated, so that no one might be forced to borrow for paying revenues.

The Commission suggested the following steps for the improvement of the famine relief agencies. A Famine Commissioner was to be appointed in all famine-stricken provinces to guide the relief work; a Famine Code was to be formulated; agricultural statistics should be collected more systematically and a separate Department of Agriculture should be set up by

every Provincial government. To obtain funds for famine relief the Commission suggested the formation of a special Famine Fund.

Among long-term measures intended to protect the people against famines emphasis was laid on the extension of railways and irrigation works, reduction of excessive dependence on agriculture by diversifying rural occupations and more liberal credit facilities for permanent land improvement schemes. The Commission's Report thus played an important part not only in the evolution of relief policies, but also in shaping the agricultura and railway policies of the government.

Flollowing the recommendations of the Famine Commission of 1878–80 a Draft Famine Code was drawn up in November 1880 by Mr. C.A. Elliot, Secretary to the Commission, and circulated to the Provincial authorities for their opinion. The Code was intended to serve as a book of instructions to government officials regarding the steps to be taken at different stages of a famine. Provincial governments were urged to draw up their own Codes on the basis of the circulated Draft with such local adjustments as they found necessary. The comments of the Provincial governments on the Draft Code helped the Government of India to prepare a revised Code which was circulated as the Provisional Famine Code in June 1883. Provincial governments were given the power to frame their own famine codes on the model of the Provisional Code, but no departure was permitted from the main principles enunciated by the latter without the formal approval of the Government of India.

The Provisional Code laid down clearly the responsibilities of local officials in relation to famine relief. For the adequacy of relief measures it laid great emphasis on local inspection. For this purpose every district was to be divided into a number of circles with Circle Inspectors who were to visit every village in their area at least once a week. The organisation of relief works was to follow a pattern laid down in the Code. There were to be two kinds of works: Civil Agency Works under the control of the district authority for the weaker and unskilled workers and Professional Agency Works under the control of the Public Works Department for the able-bodied and skilled workers. Details regarding wages, modes of payment and food rations were laid down. The works were usually to be so planned as to provide work for six months. The Code did not approve of imports of food for storage on Government account, but preferred a policy of supply of grain through selected contractors to localities where normal trading channels were not functioning.

After 1883 the Provincial governments prepared their own Famine Codes modelled on the Provisional Famine Code discussed above. Both the Provisional Code and the Provincial Codes were revised from time to time in the light of experience. All the Provincial Codes were uniform in their arrangement, the chapter headings of the codes being drawn up in the manner suggested by the Government of India.

The Provincial Famine Codes laid down the duties of various officials in the case of an approaching famine. They provided for an efficient system of reporting so that at the very first signs of distress arrangements for relief could be set in motion. A list of relief works was to be kept ready for execution in the famine-prone areas. Work suited to the ability of different groups of workers was described in the codes and appropriate wage-scales were recommended. The Codes also laid down methods for extending assistance to people who were unable to come out for work. Provisions were made for loans and advances and suspension or remission of land revenue in times of distress.

The Famine Commission of 1901 recommended several modifications in famine relief policy. In particular, they stressed the importance of opening 'test' relief works at the very first signs of a famine. The purpose of such works was to find out the extent of distress and unemployment prevailing in the neighbouring areas. The Commission suggested various measures of a 'protective' character most of which were implemented in the years before the First World War.

In spite of the advance that had been made over the years in fixing the responsibility of different administrative agencies in famine relief operations, the actual working out of relief policy depended very largely on the ability and disposition of local functionaries. Moreover, the Famine Insurance Fund was not always effectively utilised to improve the working of the agricultural economy. Only a very small contribution from the Fund was actually made available for the construction of 'protective' irrigation works. A more intensified programme of 'protective' irrigation would have contributed to a healthier growth of the country's agricultural economy.

8

Agriculture and Agricultural Policy under British Rule

The practices and methods of Indian agriculture had changed little since the early beginnings of settled life in this country, perhaps some 6,000 years ago. The crops grown had remained the same by and large until, in the nineteenth century, new agricultural products like potatoes, tea and coffee put in their appearance. Rice and wheat have been the principal cereal crops in India throughout this long period with barley and *jowar* as two important subsidiary cereals. Pulses of various types, oilseeds, cotton, jute, indigo, spices and tobacco have been grown in India since time immemorial. These crops have been cultivated by using simple, almost primitive, tools like the light wooden plough, thrashers made of wood and bamboo, and light iron implements like the spade and the sickle. The ox and the bullock have generally supplied the animal-power needed to draw the plough and have also been used to draw water out of wells for agricultural and drinking purposes. This type of simple agriculture, together with a number of small industries helping agriculture, has been the mainstay of the economic life in Indian villages throughout the centuries.

The East India Company first came to realise the export potential of some Indian agricultural products like indigo, cotton, jute and oilseeds towards the end of the eighteenth century when industrial development in England and fiscal restrictions on manufactured imports from India imposed in that country forced the Company to introduce such products in its export cargo. The cultivation of jute spread in Bengal after 1830, stimulated by demand for exports. Cotton cultivation prospered in the Deccan where some foreign varieties of cotton were introduced and acclimatised in the 1840s.

The volume of India's agricultural exports grew more rapidly in the 1850s when railways began to open up the interior of the country and oceanic transport became capable of handling bulk cargo with greater ease. After 1833 the East India Company had ceased to be a trading concern and private enterprise (mostly British) in foreign trade had begun to show a new vigour. The American Civil War (1861–64) carried the process of "commercialisation" of agriculture one step farther. British manufacturers of cotton goods who had so long derived the bulk of their raw material supplies from the U.S.A were forced to increase their dependence on Indian

cotton. Imports of Indian cotton into the United Kingdom increased 2½-fold between 1860 and 1864.[1] The price of cotton in India rose from 3.7 annas per lb. in 1860 to 11.5 annas in 1864. The cultivators responded by extending the area under cotton. The benefits of larger cotton exports at unexpectedly high prices were reaped by farmers in almost every province in British India except Bengal where the area under cotton was negligible.

After the American Civil War cotton exports gradually declined to more normal levels. Prices of raw cotton fell in the 1870–80 decade, recovered to some extent during 1880–95 and fell once again in the closing years of the nineteenth century. The early years of this century saw a substantial recovery in cotton prices until during the First World War prices rose to unprecedented heights. Exports of raw cotton formed about 60 per cent of total production in the mid-1920s, the quantity exported being over 7 lakh tons. The Agricultural Depression of 1929–32 almost halved the volume of raw cotton exports, while the fall in export prices reduced the earnings from raw cotton exports by about 75 per cent between 1925–26 and 1933–34. During the years of the Second World War cotton production declined due to diversion of area for the growth of additional cereals. On the eve of the partition of India in 1947 raw cotton exports stood at 1.6 lakh tons valued at Rs. 22.6 crores.

The area under jute increased substantially since raw jute entered the list of Indian exports in the closing years of the eighteenth century. In spite of the growth of jute mills within the country export trade in raw jute expanded over the years until, on the eve of the Great Depression, nearly 9 lakh tons were being exported annually. The Depression hit raw jute exports badly, reducing the quantity exported to only 5.6 lakh tons in 1933–34. Even more disastrous was the fall in raw jute prices from about Rs. 355 per ton in 1928–29 to Rs. 175 per ton in 1933–34. After this there was some recovery in raw jute prices and exports. The Government of Bengal adopted a scheme of area restriction on a voluntary basis in 1935 to help bring about a rise in raw jute prices. This was put on a compulsory basis in 1940. As the Indian jute mills expanded their production during the Second World War exports of raw jute fell off until on the eve of the partition they stood at 3.1 lakh tons valued at Rs. 19 crores. The war period saw a substantial rise in raw jute prices.

Exports of the foodgrains, rice and wheat, also increased in the 1860s. By 1880 about 12 lakh tons were being exported each year. It must be noted, however, that food exports from India did not necessarily indicate that domestic food requirements were fully met and the exports represented a genuine 'surplus'. The widespread poverty among the people prevented many of them from satisfying their food needs in full and the export demand

1860: 562,738 bales.
1864: 1,399,614 bales. See Gadgil, D.R., *The Industrial Evolution of India*, p. 16.

could be met only by keeping food prices beyond the reach of such people. During the First World War export control measures were introduced to conserve food supplies in the country. But up to 1919-20 India continued to be an exporter of foodgrains. From 1921 onwards India became an importer of foodgrains, but so long as Burma remained a part of India net imports of food remained small. On the eve of the Second World War average annual imports of food were about 14 lakh tons. During the war food imports dwindled. In 1942-43 India was even called upon to export rice to Ceylon with disastrous results in the form of prohibitive food prices in Bengal where 15 lakh people perished due to their inability to buy food at such prices After the war ended, larger food imports could be arranged and since the demand for food was increasing in India imports varied between 25 and 30 lakh tons during the years 1945-50.

The supply of foodgrains began to lag behind the growth of population from the early years of the present century. Mr. K.L. Datta, an official of the Finance Department of the Government of India, who was in charge of a Price Inquiry to ascertain the causes of rise in prices between 1890 and 1910, pointed out that both foodgrains acreage and production were increasing too slowly compared with the growth of population. After 1921 population growth rates accelerated but production of food crops did not keep up with it. It should be noted that estimates of foodgrains production as well as of general agricultural production were not very dependable before the Second World War. One cannot, therefore, definitely assert that *per capita* production of foodgrains actually fell throughout the period 1921-50.

There is some evidence that throughout the period 1880-1950, for which some sort of agricultural output data are available, the acreage under non-food crops increased faster than the acreage under food crops. This tendency was sought to be reversed to some extent during 1940-50 when deliberate measures were taken to induce cultivators to grow more food. High market prices of commercially important non-food crops, on the contrary, generally favoured a swing in the reverse direction during these years. At the beginning of this century about 85 per cent of the total sown area was under food-crops. In the 'thirties this proportion fell to 81 per cent. Immediately after the partition, in 1947-48, the area under various kinds of oilseeds, jute, tobacco, tea and coffee was going up, while the area under food-crops and cotton was on the decline.

Agricultural Policy

The East India Company was interested mainly in its trading activities. Its policies, therefore, were largely concerned with the diversion of domestic production towards those articles which would bring in a large trading profit. The cultivation of tea, indigo and poppy was encouraged from that limited point of view and not because any general policy of agricultural

development had been formulated by the authorities. No wonder, then, that such one-sided policies often failed to get the willing acceptance of the people. Natural principles of production and development were often set aside in the Company's eagerness to get a quick turnover of its investment.

After the great famine in Bengal and Orissa in 1866 a Commission was set up which recommended the setting up of a separate Agricultural Department in the Government of India. Nothing came out of this proposal. In 1869 under pressure from the cotton manufacturers of England the Government agreed in principle to establish Agriculture Departments in each Province with the special objective of bringing about much-needed improvement in the quality of raw cotton. An Additional Secretary was appointed in the Government of India to be in charge of Revenue, Agriculture and Commerce. Ten years later the new Secretariat was absorbed in the Home Department and its functions were largely confined to the collection of agricultural statistics. The Famine Commission of 1880 stressed the need of a Central Department of Agriculture from the point of view of "undertaking definite and permanent charge of the administration of famine relief". On its recommendation Departments of Agriculture were created in the Provincial governments, but these were poorly staffed owing to paucity of funds and scarcity of trained agricultural experts. In 1889 Dr. J.A. Voelcker, consulting chemist to the Royal Agricultural Society in Britain, was asked to advise on the best course to be adopted "in order to apply the teachings of Agricultural Chemistry to Indian agriculture and to effect improvements in it." On the suggestion of the Agricultural Conference held in 1890 when Dr. Voelcker was in India the post of an Agricultural Chemist to the Government of India was created and Dr. J.W. Leather was appointed to this post. The disastrous famines in the closing years of the nineteenth century forced the issue of agricultural development on the attention of Lord Curzon and his government. In 1901 two posts of Inspector-General of Agriculture and a Mycologist were created and in 1903 an Entomologist was added to the staff. In that year Mr. Henry Phipps of Chicago offered a sum of £30,000 to the Government of India to be spent for some useful purpose connected with scientific research. This money was used to set up the Agricultural Research Institute at Pusa in Bihar. It very soon became the chief centre for agricultural research in India and the chief source of inspiration for agricultural reforms in the different Provinces. Agricultural colleges were established at Poona, Kanpur, Nagpur, Lyallpur and Coimbatore. On the recommendation of the Famine Commission of 1901, set up after the 1899 famine, Provincial Agricultural Departments were strengthened in 1905 by addition to their research staff. This Commission was also instrumental in hastening the passage of the Cooperative Societies Act (1904). An Indian Agricultural Service was constituted in 1906. The pace of development of irrigation also quickened between 1905 and 1913.

Meanwhile, ten retired British officials and Mr. Romesh Chandra Dutt had addressed a memorial to the then Secretary of State (Lord George Hamilton) in which they argued that the land-revenue system was responsible for the ills affecting Indian agriculture. This evoked Lord Curzon's famous Resolution of January 1902 trying to vindicate the Government's land revenue policy.

The Constitutional Reforms in 1919 transferred agriculture, cooperation, local self-government, public health and sanitation to the Provincial governments. The Central government could not incur expenditure on Provincial subjects, except on agricultural research and training of research workers in Central institutions. At the same time the Provincial Ministers could do little for agricultural development as Finance was a Reserved subject. After 1935 the Provinces obtained almost full autonomy, but very soon the Second World War supervened.

The most comprehensive review of Indian agricultural policy up to the 1920s is to be found in the Report of the Royal Commission on Agriculture (1926–28). On its basis was created the Imperial Council of Agricultural Research "to promote, guide and coordinate agricultural research throughout India and to link it up with agricultural research in other parts of the British Empire and in foreign countries." The Council was intended to coordinate the agricultural research work carried out in the Provincial departments of agriculture as well as in the Universities.

As the Great Depression of 1929–32 struck Indian agriculture the Government of India at first took the view that domestic measures could do little to alleviate a depression which had its origin in world-wide causes. The only measure adopted was the imposition of a protective duty on wheat and wheat flour. The Ottawa Agreement of 1932 reached at the Imperial Conference in that year gave some concessions to Indian manufacturers but very little was done to revive exports of agricultural products. The Indo-Japanese Trade Pact of 1934 provided for the sale of a certain fixed quantity of raw cotton to Japan, in exchange for Indian purchase of Japanese piecegoods. A similar agreement with Lancashire cotton manufacturers was made through the Mody-Lees pact.

The Government of India did not find it possible to resort to a policy of currency depreciation to encourage exports. When Sterling went off gold in September 1931, the government linked the Rupee with sterling at the pre-existing ratio of R. 1 = 1s.6d although a substantial body of opinion in the country favoured the lower ratio of 1s.4d. Following orthodox financial policy the Government curtailed its own expenditure in order to have balanced budgets.[2] The result, a release of deflationary forces, further worsened the general economic situation. Interest rates rose and cut

2. Total Provincial expenditure on public works declined from Rs. 8.72 crores in 1929–30 to Rs. 5.79 crores in 1932–33.

off schemes of investment. The prices of tea and rubber, however, were sought to be raised through international action. In the case of jute the government adopted a policy of restricting the area under the crop. In U.P. a minimum price was guaranteed to sugar-cane growers. The scaling down of agricultural debts, whose burden had increased enormously during the Depression, became a recognised official policy after 1937.

One of the recommendations of the Royal Commission on Agriculture was the creation of an Agricultural Credit Department in the Reserve Bank of India. This was done under section 54 of the Reserve Bank of India Act. The statutory functions of this department were (*i*) to maintain an expert staff to study all questions of agricultural credit and be available for consultation by Central and Provincial Governments, Provincial Cooperative Banks and other banking organisations; and (*ii*) to coordinate the operation of the Reserve Bank in connection with agricultural credit and its relations with a Provincial Cooperative Bank or any other banks or organisations engaged in the business of agricultural credit.

The new Ministries which came to power in the Provinces after the elections of 1937, in accordance with the Government of India Act, 1935, undertook an extensive programme of legislation relating to debt conciliation, regulation of money-lending, tenancy reforms and rural reconstruction. They set up Rural Reconstruction Departments to coordinate the activities of all nation-building departments and provided increasing grants for their operations. Most of these Ministries, however, left after the declaration of war in September 1939, leaving the Provincial administration to bureaucrats. Even where popular ministries continued, their nation-building work was interrupted by the exigencies of the war.

During the Second World War agricultural exports were hard hit owing to the loss of important foreign markets, for example, the markets in Germany and Japan. The Meek-Gregory Mission was sent to the U.S.A. to explore new markets. The entry of Japan into war in December 1941 also created problems of supply to the eastern theatres of war. Demand for food and raw materials rose. There was increasing strain on transport. The haphazard price control stimulated hoarding and profiteering. Food crisis and famine resulted. The rise in prices of agricultural products benefited mostly the middleman, not the farmer. Prices of farmers' purchases went up even more than prices of crops. Imports of food from Australia and Canada had to be arranged. The "Grow More Food" campaign was not launched until after the disastrous Bengal famine of 1943.

By 1944 nearly 80 per cent of the area under sugar-cane and 50 per cent of the area under jute had come under improved varieties of seed. But progress in respect of food and other crops was much slower. The Provincial Agricultural Departments and the Indian Agricultural Research Institute also succeeded in evolving improved methods of pest control and

disease-resistant varieties of seeds.[3] Legislation was passed to prevent entry of foreign insect invaders into the country (The Insects and Pests Act), but little awareness was shown of the fact that insects and fungi which are harmless on their native soil might sometimes become destructive on foreign soil.

The Russell Report (1937) suggested the creation of a Central Irrigation Research station, to deal with all agricultural problems connected with and arising out of irrigation. Annual Soil Erosion conferences were recommended to be held. Biennial conferences on soil conservation and related matters used to be organised before World War II by the Crops and Soil Wing of the Board of Agriculture.

Cooperative Movement in India

Certain indigenous forms of cooperation existed in India before the advent of the modern cooperative movement based on European models. In the Punjab and several other Provinces peasants frequently joined up in teams to cultivate an area of land jointly, dividing the produce after each year's harvest according to the amount of labour and bullock-power provided by each. Cooperation for local road construction and maintenance or for joint herding of cattle was not entirely unknown. South India had developed a type of cooperative saving and financing society known as the *nidhi*.

An early instance of cooperative farming comes from Panjawar in the Punjab where, in 1891–92, the common land of a village was taken up for joint farming by a group of farmers. This experiment in joint farming was led by two officials, Edward Maclagan and Captain Crosthwaite. The State of Mysore, then under an Indian Prince, started in 1895 a scheme of cooperative banks for landholders. In Uttar Pradesh a number of cooperative village banks had been set up in the early years of this century by some enthusiastic local officials like H. Dupernex. Cooperative consumers' societies had made their appearance in Bengal at about the same time under the leadership of Ambika Charan Ukil. These cooperative societies were registered under the prevailing Companies Law and enjoyed no special privileges or exemptions.

The Government of India had begun to grope for some solution to the problem of agricultural credit after the Deccan riots of 1878–79. The first scheme given consideration was that of a State Agricultural Bank, proposals for which had come in 1882 from Sir William Wedderburn and Justice M.G. Ranade. The scheme was rejected mainly on the ground that it was undesirable to make the government a bailiff and a revenue-collector

3. Total damage caused by insects and pests to Indian crops was estimated to be nearly Rs. 180 crores in 1935.

at the same time. But remnants of the scheme found expression in two Acts, the Land Improvement Act of 1883 and the Agriculturists' Loans Act of 1884. The former permitted the institution of a system of government loans for long-term purposes connected with land improvement. The latter was concerned with short-term loans (*e.g.*, purchase of seeds and manures).[4] Each loan had to be secured by sureties or by mortgage of land. The supervision and realisation of the loans granted were in the hands of revenue officials. The amounts available for distribution as loans were usually very small.

In 1892, at the instance of the then Governor, Lord Wenlock, the Government of Madras appointed an officer, Mr. (later Sir) Frederick Nicholson, to suggest a suitable organisation for proposed agricultural banks in that Province. Nicholson, after considering various alternatives, suggested the cooperative form of organisation modelled on the Raiffeisen banks of Eastern Germany. Meanwhile Dupernex had published in book form[5] his experience of cooperative village banks in Uttar Pradesh. A Committee set up by the Government of India in December 1900 took both Nicholson's reports and Dupernex's book into consideration and recommended the establishment of Raiffeisen banks. The Famine Commission of 1901 of which Nicholson was a member further stressed the importance of checking the improvidence of the farmer in years of good harvest and pointed out the usefulness of cooperative banks in achieving this end. Another Committee was set up in 1901 to draw up a suitable set of rules for the proper functioning of such banks. Out of the deliberations of this Committee the Cooperative Societies Act of 1904 was born.

The Cooperative Credit Societies Act, enacted on 25 March, 1904, provided among other things that any 10 persons living in the same village or town or belonging to the same class or caste might apply to be registered as a cooperative society "for the encouragement of thrift and self-help among the members." The Registrar of Cooperative Societies to be appointed in each Province under this Act would be responsible for having the accounts of a registered cooperative society audited free of charge by cooperative auditors. A society was to raise funds by deposits from members and as loans from non-members, government and other cooperative societies. The funds thus obtained could be granted as loan to members only, but with the Registrar's permission, loans could also be made to other cooperative societies. Loans were to be made mostly on personal security, but land or ornaments could serve as securities. Societies were divided into rural and urban. Rural societies were those having four-fifths

4. Such loans carried forward an old tradition in the country under which the rulers used to advance money to farmers for agricultural operations. Under Mughal administration these loans were called "takavi" loans.

5. Dupernex, H., *People's Banks in Northern India*, 1900.

of their members from agricultural classes. Such societies were to function on the basis of unlimited liability of their members, an important principle of a Raiffeisen bank. Urban societies could have either limited or unlimited liability. A rural cooperative society could not distribute dividends out of its profits. All profits were to be carried to a reserve fund. In an urban society 25 per cent of profits were to be transferred to a reserve fund before declaration of dividends. A cooperative society could not issue more than a limited number of shares to any one member and in the case of a society with members' liability unlimited, a member's voting rights would be irrespective of the number of shares held. It would enjoy exemption in stamp duties and registration fees and its income would not be liable to the income tax.

The Act of 1904 thus conferred certain special rights and privileges on cooperative agencies, but only on agencies organised for purposes of credit. Other types of cooperative societies were also gradually coming into existence. In particular, societies organised with the special objective of financing and supervising the primary credit societies were discharging a very useful function by channelling a part of surplus urban funds into the rural areas. It was necessary to give similar protection to these cooperative societies as had already been given to the primary credit society. The Cooperative Societies Act of 1912 conferred the privileges of registration to all classes of cooperative societies, provided only that they aimed at "the promotion of the economic interests of its members in accordance with cooperative principles." This Act gave a cooperative society priority over other creditors in enforcing any outstanding demand on members and exempted the society's shares from attachment.

After the Constitutional Reforms of 1919 cooperation became a Provincial subject. A number of Provinces adopted their own legislation relating to cooperative societies. These generally led to a widening of the provisions of the Act of 1912, but also often increased the powers of the Registrar vis-a-vis the Society.

The Maclagan Committee was asked in 1914 to carry out a review of the working of cooperative societies in India. It made several useful suggestions including one for the establishment of an Apex Bank in each Province to augment the flow of finance to rural areas. Such Apex (Provincial) banks came to be organised on the basis of cooperation of the central (district) banks, with some individual share-holders also contributing towards capital. The cooperative movement flourished during the years of the First World War and the period of prosperity which followed that war. But during the severe depression of 1929–32 many cooperative societies were badly hit. The sharp drop in agricultural prices led many debtors to default. Many societies found that a large portion of their working capital had got locked up in unrealisable loans.

The shortcomings of the cooperative movement were subjected to

searching scrutiny by a number of enquiry committees set up by different Provincial governments in the inter-war period. The Royal Commission on Agriculture also gave some attention to the place of the cooperative movement in agricultural development and suggested a number of changes in the existing organisation of cooperative societies. But the cooperative agencies were not restored to full health by any of the measures that could be implemented at that time. The outbreak of the Second World War, by raising the prices of agricultural products, enabled the cooperative societies to recover some of their outstanding dues and put the movement on its feet again. Scarcity of goods during the war encouraged the formation of new types of cooperative societies for distribution of limited supplies or for the procurement of scarce raw materials. Between 1938–39 and 1947-48 the number of credit societies, both agricultural and non-agricultural, declined from about 100,000 to 91,700. During the same period the number of non-credit societies rose from 20,300 to over 39,000.

The re-organisation of the cooperative movement was taken up after World War II as a part of the general reconstruction schemes for the post-war period. A Co-operative Planning Committee, set up in 1946 under the chairmanship of Mr. R.G. Saraiya, suggested wider functions for the primary village society; instead of confining itself only to credit or marketing of crops the village cooperative, it was suggested, should serve the villager in all spheres of his economic life. Such a 'multipurpose' society was to have a larger area of operation in the interests of efficient working and should have no 'unlimited liability' for the members so that members could join the society without taking too large an amount of risk. The Cooperative Planning Committee also laid down certain targets for the expansion of cooperative agencies in the country. Within ten years, it was recommended, the cooperative movement should embrace 50 per cent of the villages and 30 per cent of the rural population. At the time of the Committee's report only about 17 per cent of the rural population were members of primary cooperative societies.

While cooperative societies had been started to look after the short-term credit needs of the rural population, long term credit needs of farmers called for a different type of organisation—the Land Mortgage Bank. The history of land mortgage banking in India can be traced to the Land Mortgage Bank of India, a private shareholders' bank registered in London in 1863 and modelled on the famous *credit foncier* of France. This bank worked for about twenty years, but ultimately had to close its doors because of its heavy investments in the tea industry which was then passing through bad times. Experiments with land mortgage banks on a cooperative basis were started in the Punjab on the termination of the First World War. The first cooperative land mortgage bank appears to have been set up at Jhang (Punjab) in 1920. From there the movement spread to other centres. Soon Madras stole a march over other Provinces in the matter

of establishment of land mortgage banks. Madras was also a pioneer in federating primary land mortgage banks into a Central Land Mortgage Bank in 1929. This institution permitted the centralisation of issue of debentures by the land mortgage banks. Most Provincial governments undertook to assist land mortgage banks by guaranteeing their debentures in respect of the principal and interest. Land mortgage banks adopted a system of lending money for 5 to 30 years, the most common purpose of their loans being land improvement and the redemption of old debts. In the initial years most long-term loans were taken for paying off old debts. Loans for effecting permanent improvements on land have become more common in the years since the Second World War.

By the end of March 1950 India had over 1.4 lakh primary cooperative credit societies and 283 primary land mortgage banks. Loans disbursed by these agencies in 1949–50 amounted respectively to Rs. 28.5 crores and Rs. 1 crore. The inadequate development of cooperative credit facilities, specially facilities for long-term credit, outside a few Provinces like Bombay, Madras and the Punjab, was an important barrier standing in the way of agricultural improvement.[6]

Policy Relating to Rural Money-Lending

In the old Indian village the farmer's need for seasonal agricultural finance was traditionally met by the system of *takavi* advances either by the State or by the revenue farmer (zamindar). For consumption loans the farmer had occasionally to approach the village *sahukar* (trader-cum-moneylender) who lent usually on the basis of the farmer's personal creditworthiness, mortgages of land being frowned upon by the village council. At the same time the amount of interest was never allowed to exceed the principal borrowed, a healthy principle traditionally known as *damdupat*. With the establishment of the British system of land tenures, with its full recognition of personal rights in land, cultivable land became a marketable commodity and came to be frequently pledged with the money-lender. At the same time, the growing demand for land, the increasing burden of land rents and recurring outbreaks of drought and famines made the farmer depend to a much greater extent than ever before on the funds made available by the rural money-lender. Money-lending thus became an easy method of earning an income and subsequently of acquiring valuable titles to land[7] in the event of default by the debtor. Throughout the nineteenth century

6. Nearly two-thirds of cooperative credit in 1949–50 was disbursed in two Provinces, Bombay and Madras, while U.P., M.P., and the Punjab accounted for another 22 per cent. See Planning Commission, *First Five-Year Plan*, p. 235.

7. "At the time of the annexation of the Punjab the average value of an acre of land in the Province was six times the land revenue; in 1938–39, it was 283 times." Nanavati, M.B. and Anjaria. J.J., *The Indian Rural Problem*, 1944, Ch. 12.

ownership rights in land were being lost by the ryot and acquired by moneyed interests, both rural and urban.

The situation created by such extensive loss of property by the cultivating classes exploded into riots against money-lenders and usurpers of land in several parts of the country. The agricultural riots in Poona and Ahmednagar in Bombay Presidency in 1875 are most widely known because they were followed by the appointment of a Commission of Inquiry. On the recommendations of this Commission was passed the Deccan Agriculturists' Relief Act of 1879 seeking to restrain the usurious character of money-lenders' loans and to prevent alienation of land. The Act empowered the law courts to disallow unreasonable rates of interest and to disapprove sale of agricultural land by auction unless such land was definitely pledged in connection with the loan. The Act also provided for the appointment of debt conciliators who would mediate between the money-lender and the debtors with a view to bringing down the amount payable by the latter.

The Act did not fulfil the expectations of its framers. Enquiries into the working of this Act in 1892 and again in 1912 revealed that money-lenders had found out various methods of defeating the purpose of the law. Restrictions on interest rates were got over by inflating the amount of the principal in the loan-deed, while those relating to mortgage of land were met by acquiring under agreement a sublease from the farmer on advantageous terms while the nominal ownership of the land remained with the ryot

The Government of India, disturbed by the large-scale alienation of land from the cultivating classes, sought in 1895 suggestions from the Provincial governments regarding measures against land alienation. On the basis of these suggestions were passed the Punjab Land Alienation Act of 1901, the Bundelkhand (U.P.) Land Alienation Act of 1903 and the North-West Frontier Province Land Alienation Act of 1904. Several years later, in 1916, a Land Alienation Act was passed for the Central Provinces (Madhya Pradesh). All these Acts had a common feature. They defined classes of people as 'non-agricultural' and provided that land acquired through alienation by such classes of people had to be restored to the original mortgagor after a specific number of years. In order to facilitate the re-acquisition of mortgaged land by the mortgagor on payment of a reasonable sum to the creditor at any time after the land transfer, the Redemption of Mortgages Act was passed in 1913.

These laws also failed in their purpose because no restrictions had been imposed on the transfer of land between members of the agricultural classes. Money-lenders could, therefore, operate through *benamdars* (fictitious agents) belonging to an agricultural class and acquire land almost as easily as before. At the same time the bigger agriculturists had no difficulty in swallowing up the smaller ones by giving loans at exorbitant rates of interest to the latter.

The need for regulating the money-lenders' operations and securing

loans at reasonable terms for the impecunious debtors was pointed out in strong terms by the Royal Commission on Agriculture. As a model they referred to the British Moneylenders' Act of 1927. In 1934 the Government of India summoned a conference of representatives of Provincial governments to discuss the matter. This conference reached the opinion that, rather than having an All-India Act, each Province should have suitable legislation for licensing and regulating the money-lenders within its territory. Such Acts were passed in all Provinces during the years 1933–40. While these Acts differed from one another in details, all of them provided for the maintenance of a register of loan transactions by the money-lender, for grant of receipts for payments and for furnishing the borrower with a regular statement of accounts. These Acts again generally failed to provide protection to the borrower, since in most cases the borrower was unable to move a law court against the money-lender for the latter's failure to comply with the legal provisions.

The Government also sought to give some relief to agricultural borrowers by providing in the Usurious Loans Act of 1918 that law courts could, on their own initiative, grant decrees for smaller interest payments than were originally stipulated in the loan agreement. This useful provision could, however, be invoked only when the creditor instituted a law-suit for the recovery of his loan. An amendment to the same Act in 1926 gave the debtor the right of seeking legal relief in case of usurious terms imposed by the creditor, but this right was subject to several provisos which were not easy to satisfy. The Act was further amended in several Provinces during the 1930s so that its effectiveness could be enhanced. Some Provinces, however, preferred to make the regulation of interest a part of their Money-lenders' Acts. In Bengal, for example, the Money-lenders' Act provided for certain maximum rates of interest, higher rates being allowable on 'unsecured' than on 'secured' loans. Maximum allowable rates of interest in different Provinces usually varied between 9 and 15 per cent on secured loans and between 12 and 25 per cent on unsecured loans. Compound interest was prohibited in most cases. At the same time, several Provincial Acts provided for the restoration of the *damdupat* principle under which the aggregate interest payments on a loan could not exceed in any case the amount borrowed.

These Acts could be effective if all money-lenders could be made to work under licences and under official supervision. Licensing, though provided in most Money-lenders' Acts, could, however, be evaded by the money-lender. The Acts provided that a money-lender operating without a licence could not move a court for the recovery of arrears. But in most cases the money-lenders had no occasion to have recourse to a law-court and so could forego a licence with impunity.

During the years of the Great Depression the burden of rural debts enormously increased in real terms. There was also need for more frequent

borrowing and the amount of indebtedness increased in money terms as well. According to estimates current in the 1930s the aggregate rural indebtedness went up from Rs. 900 crores in 1930 to Rs. 1,800 crores in 1938.[8] It became essential to introduce speedy measures of debt relief for the agricultural borrower if his economic recovery was to be secured.

The United Provinces government took the initiative in this respect in 1932. All decrees awarded by civil courts in favour of creditors were ordered to be held in abeyance until fair selling values of land were decided by the District Collectors. In 1934 the U.P. government passed the Encumbered Estates Act staying legal proceedings in respect of debts incurred by landholders, many of whom also suffered from the agricultural depression almost as much as the ryots. Another Act in the same Province in 1937 provided for stay of legal proceedings against tenants and small holders as well. All agricultural debtors in civil prisons were released and arrest of such debtors in execution of decrees was prohibited.

Moratorium on the execution of decrees and on the conduct of legal proceedings against agricultural debtors was also imposed in several other Provinces. But a solution of the rural debt problem on a more permanent basis had to be worked out. This solution had to take the form of scaling down of outstanding debts so as to bring them within the repaying capacity of the impoverished borrowers. The Central Provinces government took the first step in this respect by passing a Debt Conciliation Act in 1933. This was followed between 1934 and 1937 by similar legislation in most other Provinces as well as in some of the 'States' under the Indian Princes. The object of these Acts was to set up Conciliation Boards which were to adjust the total debts of an agricultural borrower to his available assets. The Boards were also to suggest suitable instalments for debt repayment, taking into account the repaying capacity of the borrower. The Boards, however, could scale down debts only when a certain stated proportion (40–50 per cent) of the creditors agreed to accept a scheme of conciliation. The recalcitrant creditors were penalised by providing that they would not be entitled to costs if they obtained a decree against their debtors in the law courts, nor could they claim an interest of more than 6 per cent per annum in such cases. On the other hand, those creditors who accepted the scheme suggested by the Conciliation Board would be entitled to priority in the recovery of their debts and instalments due to them could be recovered through the government's revenue officials.

The Conciliation Boards rendered useful service during the depression years. But they were not given the authority to scale down all types of liabilities which had become burdensome owing to the sharp fall in agri-

8. The former figure is the Central Banking Enquiry Committee's estimate of rural indebtedness. The latter figure was arrived at by Mr. E.V.S. Maniam in a paper on "Essentials of Rural Development". See Nanavati, M.B. and Anjaria, J.J., *op. cit.*, p. 44.

cultural prices. For example, rent liabilities or debts to cooperative societies, banks and the government could not generally be scaled down. The Boards, moreover, could move in the matter of debt conciliation only when the creditors or debtors applied. In many cases the debtors' applications would contain defects, mainly owing to the ignorance of the peasant about legal provisions, and would be rejected by the Board. The Boards themselves often consisted of semi-literate and incompetent members. Compared to the number of cases requiring disposal too few Boards were set up, with the result that cases accumulated and realisation of debts was delayed. This in turn produced a scarcity of liquid loanable funds in the rural areas and aggravated the problem of shortage of seasonal working finance for agriculture.

In addition to *voluntary* conciliation, which could take effect only when a certain proportion of creditors agreed to accept a smaller sum than what they could legally claim, measures were adopted in certain Provinces for *compulsory* conciliation as well. By the Madras Debt Relief Act of 1938, for example, creditors were prevented from recovering in the aggregate more than twice the sum originally borrowed. Further, some part of the interest outstanding on relatively old loans was straightaway cancelled and maximum limits were imposed on the interest to be recovered in respect of more recent loans. Relief was also given by this Act to tenants who were in arrears of rent. In 1939 similar Acts were adopted by the Central Provinces, the United Provinces and Bombay.

Compulsory conciliation, of course, made the Boards' proceedings independent of the caprices of creditors. But it did not necessarily reduce the debt burden to a greater extent than did voluntary conciliation.[9] Moreover, mere scaling down of debts could not afford sufficient relief to debtors in extreme distress. In the absence of easy access to alternative sources of finance, many debtors could not repay even their scaled-down debts.

Policy Relating to Agricultural Marketing

With the growing commercialisation of agriculture, the problems of systematic marketing of agricultural products and of realisation of a remunerative price by the farmer had acquired increasing significance. The farmer had generally to suffer in his dealings with the commercial interests engaged in agricultural marketing because of his ignorance, his lack of communications with important marketing centres, lack of holding power caused by inadequate access to cheap finance and lack of satisfactory storage space. The use of a bewildering variety of weights and measures in different parts of the country also added to the confusion of agricultural marketing, while

9. Nanavati, M.B. and Anjaria, J.J., *op. cit.*, p. 235.

absence of opportunities for objective grading left the farmer at the mercy of unscrupulous commercial buyers and their agents.

Although the Government of India declared the 'maund' (measuring $82\frac{2}{7}$ lbs.) as the standard weight throughout India as early as 1913, active measures to make this policy effective were not contemplated at the time. Some Provincial governments took sporadic action in limited areas, but the all-India Standards of Weight Act was passed only in 1939. In several Provinces legislation was adopted in the 1930s for the establishment of 'regulated' markets where transactions could be effected under prescribed regulations so as to protect the seller against false weights, unauthorised deductions and other fraudulent practices.

The Royal Commission on Agriculture (1928) had noted the absence of an agricultural marketing organisation at the governmental level and had recommended that both the Central and the Provincial governments should take steps to fill up the lacuna. Accordingly the Government of India appointed in 1934 a Principal Marketing Adviser to the Imperial (now Indian) Council of Agricultural Research. The Provincial agricultural departments also began to be strengthened on the marketing side in the late thirties. In 1937 the Central legislature passed the Agricultural Produce (Grading and Marketing) Act in order to set up arrangements for inspection and grading of products. The 'Agmark' certificate granted under the provisions of this Act guaranteed the quality of the product to consumers, prevented misrepresentation and widened the market for agricultural products.

Cooperative marketing was introduced in many parts of the country, specially in connection with the trade in cotton, jute, sugarcane and tobacco, but in most cases their organisation was not satisfactory. Apart from internal problems of organisation due to lack of literate and market-conscious managerial staff, the cooperative marketing societies also suffered from the open hostility of powerful private trading interests. One of the factors hindering the formation of such societies in larger numbers was the obligation of the chronically indebted farmer to sell his crops, often at unduly low prices, to his *Mahajan* or money-lender. It was thus obvious that credit had to be linked up with marketing if cooperative marketing was to be successful. This, in turn, implied the need for making additional liquid funds available for a longer period so that the cooperative society could wait for the realisation of better prices for its sales. It was necessary also to make long-term finance available to the cooperatives for the construction of storage space.

9

Agriculture and Agricultural Policy since Independence

The Independence of India in 1947, along with the partition of the British Indian territory and the amalgamation of the former Princely States, led to significant changes in the balance between agricultural production and requirements. British India produced on an average about 60 million tons of cereals in the 1940s. After partition the territory of the Indian Union was in a position to produce about 43.2 million tons, whereas consumption requirements were put at 45.8 million tons. The Grow More Food campaign, introduced in 1943, was geared up after Independence and definite targets were laid down for additional production of cereals in different Provinces and States. These targets were intended to raise the production level by 4 million tons in 1951 when requirements would also go up due to population growth. For the achievement of the production goals a new post of Commissioner of Food Production was created at the Centre. An Emergency Branch was set up in the Central Ministry of Agriculture to coordinate the food production plans of the different Provinces and States.

The plan for additional food production could be regarded as made up of three components. The short-term plan was to increase the yield from land already under cultivation through the provision of better seeds, application of more manures and chemical fertilizers, better measures of plant protection and wider use of existing irrigation facilities. In the medium term, schemes for the reclamation of weed-infested land were to be taken up and heavy tractors were to be imported from the U.S.A. for this purpose. The long-term plan consisted in the preparation and execution of large irrigation schemes, many of which would be designed as multi-purpose schemes for power generation and flood-control as well. The expansion of irrigation facilities was expected to lead not only to increased food production but also to larger output of commercial crops like cotton and jute which were also in short supply after the partition.

To enable the Provincial governments to realise the targets of additional production allotted to them, loans and grants under the Grow More Food campaign came to be provided on a more liberal basis than before. The immediate outcome, however, was highly unsatisfactory, since both the area under foodgrains and the production of foodgrains were *lower* in 1948–49 than in 1947–48. Consequently, food imports had to be stepped up

from 2.7 million tons in 1946–47 to 3.25 million tons in 1947–48 and further to 4 million tons in 1948–49. In 1949–50 there was a recovery in cereals production, followed by another severe set-back in 1950–51 [1]

It is necessary to note that much of the available statistics during this period is non-comparable because of changes in the geographical area covered and in methods of data collection and analysis.

More reliable than the data on area cultivated and production levels are the data on imports. Imports of foodgrains rose steadily during the years 1946–51 (except in 1950), the annual average for the period being about 3 million tons. The food deficit in 1950 was estimated as 6 to 7 per cent of total production. But with the population growing all the time, the size of the deficit was also bound to grow bigger.

The partition in 1947 also created a need for larger imports of raw cotton. The requirements of raw cotton for Indian cotton mills could not be met from domestic production in the territory of the Indian Union. Nearly three-fifths of the long-staple variety of cotton was produced in the areas now included in Pakistan. Accordingly measures had to be adopted for increasing the levels of domestic production as well as for improving the quality of raw cotton.

A similar problem existed in the case of raw jute. The requirements of raw jute for the Indian jute mill industry were largely met before the partition by the areas now included in the eastern wing of Pakistan (which became the independent State of Bangladesh in 1971). The Indian Union's deficit in raw jute was estimated at 35 to 40 lakh bales.[2] Domestic production in the Indian Union was no more than about one-fifth of undivided India's total production at the time of partition.[3]

One of the primary objectives of India's First Five Year Plan (1951–56) was to augment the production of agricultural products in short supply – specially, cereals, cotton and jute. In 1950–51 India was having to spend over Rs. 80 crores on imports of cereals, about Rs. 101 crores for imports of raw cotton and nearly Rs. 28 crores on imports of raw jute. There was also some shortage in sugarcane and oilseeds. As the Planning Commission observed in the Plan document issued in 1952, "In the pre-

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1. Cereals production in India (million tons)

1936–37 to 1938–39 (average)	46.2
1946–47	42.5
1947–48	43.7
1948–49	43.3
1949–50	46.0
1950–51	41.8

(See Jain P.C., *Problems in Indian Economics*, p. 86).

2. (1 bale = 400 lbs.)

3. In 1947–48 the production of raw jute was about 17 lakh bales in Indian Union and 68 lakh bales in East Pakistan. See Ghosh, B.B., *Indian Economics and Pakistan Economics*, p. 86.

sent Plan period, agricultural development receives the highest precedence, which necessitates an extensive programme of irrigation covering minor as well as major projects. Generation of electric power, which is linked in most cases with the major irrigation projects, has also a high priority in its own right". In the Five Year Plan for 1951–56 as much as 38.5 per cent of the proposed outlay of Rs. 2069 crores was allocated under three heads, *viz.*, Agriculture and Community Development, Irrigation and Multi-purpose Irrigation and Power Projects. An aggregate outlay of Rs. 795 crores on agriculture-related development was expected to result in a 14 per cent increase in foodgrains production in 1955–56 (over 1949–50) as well as increases in the production of raw cotton by 42 per cent (over 1950–51), of raw jute by 63 per cent, of sugarcane by 12.5 per cent and of oilseeds by 7.8 per cent.

The higher levels of agricultural production were to be reached by extension of cultivation through reclamation of waste land, expansion of the irrigated acreage, provision of improved seeds and larger doses of fertilizers as well as the introduction of better farming practices. It was expected that nearly 74 lakh acres of land could be reclaimed with the help of tractors and another 64.5 lakh acres could be redeveloped through proper drainage of excess water and other protective measures such as contour bunding. The construction of irrigation canals had made some progress even under British rule, particularly after irrigation became a Provincial subject following the Constitutional Reforms in 1919. In 1941–42 the total capital invested in 'productive' (that is, revenue-yielding) irrigation works in India was estimated at about Rs. 103 crores and the net revenue from irrigation was over Rs. 10.66 crores. However, of the 27 million acres of land under canal irrigation in 1946–47 nearly 14 million acres went to West Pakistan because of the partition. Taking into account all types of irrigation works, major and minor, government-owned and privately-owned, the Indian Union had about 50 million acres of land under irrigation in 1949–50. Programmes of irrigation development in the First Five Year Plan were designed to raise the irrigated area to 65.6 million acres. As a percentage of the cultivated area the irrigated acreage was less than 15 per cent in 1949–50; this was proposed to be raised to nearly 20 per cent.

The domestic production capacity of chemical fertilizers was still very small when the First Plan was taken up for implementation Programmes for fertilizer use were therefore adopted with great circumspection and schemes for utilising organic manures were given some importance. The production target for nitrogenous fertilizers was fixed at 4.5 lakh tons (as compared with 0.5 lakh tons in 1950–51) and that for phosphatic fertilizers was fixed at 1.8 lakh tons (three times the 1950–51 figures). The financial outlay for the development of the fertilizer industry may be properly regarded as a key element in the plan for agricultural development.

A good deal of attention was given in the First Five Year Plan to the

building up of a suitable administrative structure to facilitate the execution of rural development projects. It was accepted as a general principle that the primary requirement for development in a stagnant economy was "to bring about a change in the mental outlook of the people, and to instil in them an ambition for higher standards of life." The participation of the people in planned development effort, with voluntary labour or cash donations, was sought to be encouraged through the Community Development Projects inaugurated on Mahatma Gandhi's birthday (October 2) in 1952. Similarly, the need for making essential agricultural services (for example, advice on the nature and dosage of manures) more easily available to the villager led to the setting up of the National Extension Service in October, 1953. For both C.D. and N.E.S. projects the administrative unit was a Development Block covering more or less 100 villages and a population of 60 to 70 thousand. These blocks were set up gradually, since every such block would have to be provided a minimum financial support. By 1955–56 nearly 300 C.D. blocks and 900 N.E.S. blocks came into existence in different parts of the country. Nearly 2 crore people were covered by the C.D. blocks in about 33000 villages. The N.E.S. blocks covered almost 6 crore people in 90000 villages. A C.D. project usually consisted of 3 development blocks.

The N.E.S block was entrusted with a relatively limited number of functions as compared with a C.D. block. The former was concerned primarily with the provision of agricultural services, while the latter was intended to encourage the total development of community life in the villages. The government's financial outlay for a C.D. block was almost three times the outlay for an N.E.S. block. The N.E.S. blocks were set up on the basis of the recommendations of the Grow More Food Enquiry Committee (1947) who suggested that, for agricultural development schemes to succeed, there should be one village-level worker (VLW) for every five or six villages whose main function would be "to convey to the farmer the lessons of research and to the experts, the difficulties of the farmer". The VLW was also to arrange for regular supply of seeds and manures and provide for services of veterinary and plant-disease experts when needed.

The Community Development idea was the outcome of certain experiments in rural development conducted in U.P. and elsewhere by American and Indian social service workers. The villagers, it was felt, had to participate fully, and of their own accord, if rural development schemes were to have a lasting impact on the villagers' work habits and behaviour pattern. The introduction of the C.D. programme was facilitated by the availability of financial help under the Indo-U.S. Technical Co-operation Programme. Funds were also provided by certain U.S. agencies to carry out continuous evaluation of the C.D. projects. Each development block was to have a complement of multi-purpose village-level workers who were to serve as local agents for all government departments concerned with rural develop-

ment. All such departments were to be represented at the block level by technical specialists whose work was to be co-ordinated by an official belonging to the administrative cadre of the government and designated as the Block Development Officer (B.D.O.). The B.D.O.s were to be accountable for their work to the District development authorities.

The organisation of rural development took a new turn with the establishment of Panchayati Raj institutions on the recommendations of the Balwant Rai Mehta Committee (1958). The Committee, after studying the progress of community development work in the country, reached the conclusion that public participation in development work required the introduction of elected bodies at the village, block and district levels. These bodies, modelled on the ancient institution of Panchayat in Indian villages, came to be described as Panchayati Raj institutions. The structure of such institutions was allowed to vary from State to State, depending on local preferences and traditions. In this structure the block came to be regarded as the lowest unit in respect of which separate development plans could be drawn up. The Block Development Officer was to act as the principal executive officer of the elected body at the block level (usually called the Panchayat Samiti), while the District Magistrate or his subordinate officer would be looking after the affairs of the elected district-level body (usually called the Zilla Parishad). By the beginning of the 1980s there had come into existence over 2 lakhs of village panchayats, 4481 block-level Panchayat Samitis and 252 Zilla Parishads. The working of the Panchayati Raj institutions was reviewed by a Committee working under the chairmanship of Ashoka Mehta in 1977.

The powers and functions of the Panchayati Raj agencies are not uniform in all States. In general, they are responsible for agricultural development programmes, rural industrial units, rural health and sanitation, maintenance of irrigation works and organisation of recreational facilities. They are endowed with power to levy certain taxes, though in some States they depend solely on grants made available for their use by the State government. There is general agreement that the block-level institutions have been rendered somewhat ineffective in recent years, partly due to the inadequate financial support which they receive and partly due to the indifference of agencies at higher levels to involve them in development work.

Agricultural Credit Institutions

For many years before Independence co-operative institutions for the provision of both short-term and long-term credit to farmers had been at work in India. The Depression of 1929-32 left many of them debilitated, but the gains made during the period of the Second World War helped to put the credit institutions back on their feet. In 1949-50 the amount of co-operative short-term advances was Rs. 28.53 crores, a more than four-

fold increase over the amount advanced in 1938–39. But the co-operative institutions were not very successful outside the two Provinces of Bombay and Madras; nearly two-thirds of co-operative societies' advances were made in these two areas. Land Mortgage banks which made long-term advances, transacted a business of only Rs. 1 crore during 1949–50, most of these advances being confined again to Bombay and Madras. *Takavi* loans granted for agricultural purposes by the State had risen to Rs. 15 crores by 1949–50 as compared with Rs. 1 crore in 1938–39. But, as the Reserve Bank of India's (RBI) Rural Credit Survey (1953) revealed, the bulk of agricultural loans came from rural money-lenders and traders who usually charged very high rates of interest.

The Committee of Direction of the RBI Rural Credit Survey recommended that the State ought to play a more active role in re-vitalising co-operative credit institutions. The State governments were asked to contribute to the share capital of these institutions. To facilitate such 'State-partnered' co-operation the RBI was advised to create a National Agricultural Credit Fund from which loans were to be made to State governments for purchase of shares of co-operative credit agencies. Another fund, known as the National Co-operative Development Fund, was to be created by the Central government to make advances to States for taking up shares in non-credit co-operative institutions. With their resources thus augmented the co-operative institutions, it was believed, could make advances on a larger scale to their members. To build up a link between agricultural credit and marketing, schemes for the construction of warehouses and godowns were taken up. Warehouse receipts were to be used as instruments for borrowing (at the post-harvest stage) by farmers who would deposit their produce at the warehouse instead of selling it outright at the depressed prices following a good harvest.

The RBI also liberalised its conditions for making advances to State-level co-operative agencies (State Co-operative Banks) which financed the district-level agencies (Central Co-operative Banks) and the primary credit societies. The period for repayment of RBI advances was extended from 9 months, as under the RBI Act of 1934, to 15 months and in some cases to 18 months. The rate of interest on such advances was also reduced.

As a result of all these developments the proportion of co-operative societies' advances to total loans incurred by farmers began to improve. This proportion is believed to have gone up from 3.1 per cent in 1953–54 (according to RBI Rural Credit Survey) to 33 per cent in 1967–68 (according to All-India Rural Credit Review Committee). But co-operative credit societies are still very unevenly distributed among the several States of the country, their membership is limited to the relatively affluent section of farmers, they have to work largely on the basis of funds borrowed from the RBI and many of the societies have run into large amounts of overdue loans thus impairing the viability of the co-operative credit structure.

The Rural Banking Enquiry Committee had recommended as early as 1950 that, in view of the limited development of co-operative credit agencies, measures ought to be adopted to make commercial banks interested in financing agriculture. Some amount of marketing credit was being provided to agricultural trading interests by the commercial banks even before Independence. But loans for financing productive schemes or direct loans to farmers for arranging storage of their crops were regarded as outside the purview of commercial banks' normal activities. The Rural Banking Enquiry Committee had recommended the opening of new branches by the Imperial Bank of India, then the biggest private commercial bank in the country, in centres closer to rural areas. The target fixed by them for such expansion was 274 branches in five years starting from July, 1951. But the Imperial Bank showed no inclination to achieve this target. The Government of India decided, therefore, to regulate the Imperial Bank, now renamed as State Bank of India and fixed on it the statutory responsibility of opening at least 400 new branches within five years. The centres for the location of the new branches were to be selected by consultations between the Central Government, the RBI and the SBI authorities. By 1960 the number of new branches opened was 416, but the selection of centres was not always made with an eye to the potential of agricultural business.

Concern over the distribution of commercial bank credit, with the objective of making such credit more effective for the realisation of the agricultural targets in the Five Year Plans, began to grow within the country. In May 1967 a non-official resolution in the Rajya Sabha (Upper House of Parliament) called for the nationalisation of banks. The government responded in December 1967 with the establishment of a National Credit Council who were entrusted with implementing a policy of 'Social Control' of credit. The NCC, which consisted of representatives of various interests, was expected to determine priorities in the field of distribution of commercial bank credit. But it had no implementing authority. Following discussions at the NCC, the RBI would issue guide-lines to the management of different banks. Although the NCC fixed certain targets for the allocation of bank loans to agriculture (Rs. 65–70 crores for the period July 1968–June 1969), these targets were too low and were easily fulfilled. These agricultural loans, however, went wholly to agencies concerned with fertilizer distribution and construction of storage facilities, and not to farmers for development of productivity in their farms.

It was in this context that 14 major commercial banks came to be nationalised through the issue of an Ordinance on July 19, 1969. Another 6 banks were nationalised on April 15, 1980. Following nationalisation the banks have now increased their operations in the field of agricultural credit. Over 55 per cent of commercial bank branches are now (1985) located in rural areas as compared with only 22 per cent immediately before the bank nationalisation of 1969. A new type of credit institution, the Regional Rural

Bank, has been ushered into existence since 1976 to cater primarily to rural needs. In 1982, the National Bank for Agricultural and Rural Development (NABARD) was set up to co-ordinate the activities of rural credit institutions. With its establishment the RBI's supervisory role over co-operative credit institutions has been transferred to this institution.

In spite of all these institutional innovations, the ability of organised credit agencies, as distinct from traditional money-lending interests, to cater to the needs of agricultural borrowers remains limited. Because of the accumulation of overdues the flow of co-operative credit to rural areas has begun to slow down. The share of the agricultural sector in gross commercial bank credit was no more than 11.8 per cent in 1979 and reached only 15.3 per cent at the end of December 1985. Because of their insistence on too many formalities and their limited working hours bank credit still remains less acceptable to the agricultural borrowers than money-lenders' loans. The Sixth Plan (1980-85) projected for agriculture and allied sectors a growth in institutional credit from Rs. 2550 crores (1979-80) to Rs. 5415 crores (1984-85). This goal was to be achieved by increasing the proportion of commercial bank loans going to agriculture as well as by an increase in the number of Regional Rural Banks working in different parts of the country. However, with the expansion in bank loans to agriculture, the problem of timely realisation of such loans has been posing some problems.

A Review of Agricultural Development Since 1951

Although problems still remain regarding planning at the block and district levels for agricultural development as well as adequate institutional financing of farm-level activities, the policies followed at the national and State levels have succeeded in bringing about since 1951 a substantial improvement in most types of agricultural output. The index of agricultural production (1967–68 to 1969–70 average = 100) for all crops, which stood at 58.5 in 1950-51 rose to 86.7 in 1960-61, 112.4 in 1973-74 (end of Fourth Plan) and further to 138.0 in 1978-79 (end of Fifth Plan). In the case of cereals the gain was greater; the index rose from 53.8 in 1950-51 to 143.1 in 1978–79. Among major crops the biggest rise was witnessed in the case of wheat (from 37.8 to 193.9 in the same period), which benefited from the high-yielding varieties of seed introduced into India from Mexico (around 1965-66) and modified to some extent by local research. Within a space of eight years, between 1965-66 and 1973-74, the production of wheat more than doubled. This phenomenon has often been described as the Green Revolution, although it was primarily a revolution in the technology of wheat production and remained confined in the main only to Punjab, Haryana and Western Uttar Pradesh. A revolution on a comparable scale occurred also in the production of potatoes, ginger and natural rubber,

but the importance of these products is far less than that of wheat. The most important cereal crop of the country, rice (paddy), also benefited from the introduction of a few high-yielding varieties, but not to the same extent as wheat. Pulses as a group (having a weight of 8.07 per cent in crop production) registered a decline after 1960-61, though their production had increased by nearly 25 per cent between 1950-51 and 1960-61. Fibre crops (cotton, jute and mesta) and oilseeds also registered at least a doubling of production levels between 1950-51 and the closing year of the Fifth Plan (1978-79).

Part of the increase in agricultural production was attributable to an increase in the cropped area through waste land development and multiple-cropping on irrigated land. But in the case of most crops the greater part of the increase in production was due to the increase in yield per acre. The average yield of wheat more than doubled between 1950-51 and 1978-79, but in several other minor crops like ragi and jowar the average yield went up even more, their smaller rate of increase in production being due to the shrinkage of the area under cultivation. In rice the per acre yield went up by nearly 90 per cent. Productivity declined in respect of some pulses and spices like black pepper and chillies

By 1978 the Indian Union became able once again to provide, without depending on food imports, at least 424 grammes of cereals per day to all its inhabitants. This contrasts strikingly with the situation in 1951 when, despite food imports of 4.8 million tonnes, the per capita daily availability of cereals was no more than 335 grammes. However, the average cereals quota has hardly any practical relevance, since this has to be purchased on the market and a large section of the Indian population is yet without adequate purchasing power and has to remain under-fed. An estimate made for 1970-71 by the Seventh Finance Commission (1978) put the number of such people, living below the Poverty Line, at 27.8 crores in 15 major States covered. They formed about 52 per cent of the total population in these States. In 1979-80 the number of people below the Poverty Line was estimated at 31.6 crores.[4] But because of differences in concepts the two sets of figures are not comparable.

In the absence of adequate demand from prospective consumers, some of the foodgrains have to be purchased on government account both to prevent a fall in crop prices and to build up food stocks that can be used in a year of scarcity. But though a certain amount of stock-piling may be useful, too large a stock involves heavy storage cost and often leads to deterioration of the stored grains. The increased production of food-grains since 1951 has been of little use in improving the level of food intake of nearly half the population of the country. It is only by drawing such people into productive activity and endowing them with greater purchasing power that this problem of 'poverty amidst plenty' can be solved.

4. This was 48.4 per cent of the estimated total population in that year.

10

The State and Industry under British Rule

In the early days of British rule the East India Company did not think it improper to come to the aid of Indian industries, by financial as well as organisational assistance, since many Indian industrial products figured in the Company's exports. As manufacturing interests increased their strength in Britain, they played an active part in bringing about the cessation of the Government of India's active involvement in industrial projects. The period of transfer of Indian administration from the East India Company to the British Crown was also the high noon of *laissez-faire* doctrines. Under the Crown the British administration in India became very largely apathetic to industrial growth.

The importance of industrial development could not, however, be lost sight of altogether, since the problem of excessive pressure on agriculture was being keenly felt with the decline of the traditional handicrafts. Attention to the need for diversification of occupations was drawn most pointedly by the Famine Commission of 1880. The Commission's Report discussed fairly extensively both the possibilities and limitations of Government action in relation to industrial development. It is unfortunate that little attention was paid to the positive aspects of the policy advocated by the Famine Commission and only a very cautious policy was adopted in the matter of industrial training, demonstration and the purchase of indigenous stores for State purposes. A Government Resolution of 1883 asked officers to limit their indents on the European market to those articles only which could not be obtained in India but no effective measures were taken to increase the range of articles that could be indented from India.[1] Two other consequences of the Famine Commission's thought-provoking Report were: (*a*) the establishment of a Commercial Museum in Calcutta, and (*b*) an examination of Indian industrial products by the Government Reporter. A beginning was also made in the field of technical and industrial education.

The spirit of the Famine Commission's recommendations, however, inspired the Government of Madras which initiated an experiment in State

1. For an account of the Government of India's Stores Purchase policy during 1883-1928, see Sen, S.K., *Studies in Economic Policy and Development of India (1848–1926)*, Ch. II.

sponsorship of certain selected industrial crafts towards the end of the 19th century. Lord Curzon, the Viceroy, subsequently felt the need for a coordinated policy of stimulating industries and created in 1905 a separate Department of Commerce and Industry in the Central Government. The pioneering example of the Government of Madras was also taken up by some other Provincial governments, notably U.P.

In 1908 an Industrial Conference was held in Ootacamund which advocated a larger share for the Government in industrial activities. But industrial interests in the Conference, largely Europeans, were not very favourably disposed to such proposals and sought to limit the State's functions to initial demonstration and training. When the Government of India sought the permission of Lord Morley, the Secretary of State for India, to create a permanent Department of Industries for the purpose of pioneering industries, the latter refused to sanction anything which might lead the government to embark on a commercial venture. "State funds", he suggested, "may be expended upon familiarising the people with...improvements in the methods of production...; further than this the State should not go, and it must be left to private enterprise to demonstrate that these improvements can be adopted with commercial advantage." Lord Morley's successor, Lord Crewe, was a little more responsive to the Government of India's suggestions for a positive industrial policy. He was prepared to allow Government to purchase and maintain experimental plants for demonstrating improved methods of production. But the Government of India remained vacillating and although Provincial Departments of Industries came into being they continued to play only a very limited role in the promotion of new industries.

The First World War brought out clearly the importance of making India industrially stronger and more self-sufficient. The Government of India in their despatch of November 26, 1915, urged upon the Secretary of State the need for making India industrially better equipped with the required assistance forthcoming from the State. In 1916 the Industrial Commission was appointed with the following terms of reference:

(*a*) whether new openings for the profitable employment of Indian capital in commerce and industry can be indicated:

(*b*) whether, and if so, in what manner, government can usefully give direct encouragement to industrial development, (*i*) by rendering technical service more readily available; (*ii*) by the demonstration of the practical possibility on the commercial scale of particular industries; (*iii*) by affording, directly or indirectly, financial assistance to industrial enterprises; or (*iv*) by any other means which are not incompatible with the existing fiscal policy of the Government of India.

At the same time as the Industrial Commission was going through its deliberations, the Government of India took a further measure to

stimulate local manufacture of stores required for the purposes of the War. In April 1917 the Government set up the Indian Munitions Board "to control and develop Indian resources, with special reference to the needs created by the war to limit and coordinate demands for articles not produced in India, and to apply the manufacturing resources of India to war purposes with the special object of reducing the demands on shipping." The Board initiated measures to purchase stores for the Army inside the country and to encourage the establishment of new plants or development of established plants in order to augment the indigenous supply of such stores. The Board was able to discover that in many cases reliance on foreign articles could be dispensed with by giving suitable encouragement to domestic suppliers. The success attending the work of the Munitions Board helped in crystallising opinion in the Industrial Commission. In its Report, published in 1918, the Commission enunciated two basic propositions regarding the future industrial development policy of the Government of India. First, the Government was required to play a more active part than hitherto in industrial development and, secondly, an adequate administrative apparatus had to be built up in the coming years if the Government had to discharge its proper role in industrial development.

After the War the Government of India Act of 1919 made Industries a Provincial transferred subject entrusted to a Minister responsible to the Provincial Legislature. But the Central Government was to play its part in a coordinating capacity and a Central Department of Industries was created under Sir Thomas Holland who had presided over the Industrial Commission a few years earlier, An important step to encourage the purchase of Government stores in India was taken with the appointment of the Stores Purchase Committee in December 1919. One of its recommendations was to provide industry with guaranteed minimum orders for Government purchases. This measure was of considerable help to the Indian Iron and Steel industry in the immediate post-war period. At this time many British and European competitors were trying to recover lost ground in the Indian market. Prices quoted by them were sometimes even below the commercial cost of production. It was stated by a Committee, set up in 1922 to re-examine the Stores Purchase Rules, that asking newly established Indian industries to compete on the basis of price quotations with established European industries was unfair and unhelpful. The Committee, therefore, expressed themselves in favour of a policy of protection which would enable Indian industries to recover their higher cost, undeterred by foreign competition.

The policy of protection was at this time a very live issue in India. Already in March 1916 a Resolution in the Central Legislative Council, moved by Sir Ibrahim Rahimtoola, had demanded that the question of granting tariff protection to Indian industries should be thoroughly examined. But when the Industrial Commission was set up in May that year,

the Commission's terms of reference did not include the issue of tariff protection. Great disappointment was caused by this exclusion. It was pointed out at the time that until the question of giving full fiscal autonomy to the Government of India had been settled, it would be premature for a Commission of Inquiry appointed by the Government of India to go into issues of fiscal policy. The hurdles were cleared in 1919 when the British Parliament's Joint Select Committee on Indian Constitutional Reforms came out in its Report clearly in favour of fiscal autonomy for India. "In the opinion of the Committee," the Report said, "the Secretary of State should, as far as possible, avoid interference (regarding fiscal policy) when the Government of India and its Legislature are in agreement." This view was endorsed by the Secretary of State in his Despatch to the Government of India dated June 30, 1921.

Although a legally endorsed protectionist policy was not adopted until a few years later, the Government of India's financial difficulties during and after the war were forcing it to adopt a near-protectionist tariff policy. In 1916 the general rate of import duty was raised from 5 per cent *ad valorem* to 7.5 per cent. This rose in 1921 to 11 per cent and in the following year to 15 per cent. These high rates of duty, albeit imposed for revenue purposes, were already making such inroads into doctrinaire free trade principles that a policy of protection no longer met with active resistance from any quarters. By a Government of India Resolution dated October 7, 1921, a Fiscal Commission was set up with Sir Ibrahim Rahimtoola as its Chairman.

The Policy of Fiscal Protection to Indian Industries

The Indian Industrial Commission (1916–18) had expressed itself in favour of protectionist policies for developing modern industries in India. Examining this issue in greater detail the first Fiscal Commission, appointed in October 1921, formulated a policy for grant of fiscal protection to deserving industries in the initial stages of development or in cases where they were under pressure from *unfair* foreign competition.

For the selection of industries which, if granted protection in the early stages, would be able to develop to their full stature in India, the majority of the Fiscal Commission suggested the following principles of 'discrimination':

(*i*) the industry must be one possessing natural advantages, such as an abundant supply of raw material, cheap power, a sufficient supply of labour, and a large home market;

(*ii*) the industry must be one which without the help of protection is not likely to develop at all, or as rapidly as is desirable in the interests of the country;

(*iii*) the industry must be one which will eventually be able to face world competition without protection.

These three principles, often referred to as the 'triple formula' of the Fiscal Commission, were no doubt eminently reasonable. It is economically unsound to grant protection to an industry which offers no prospect of eventual development and cannot turn out products at a reasonable cost within a reasonable period after the grant of protective assistance. The formula, however, overlooked that in some cases this economic logic may have to be set aside. An industry needed for the country's defence, or a basic industry whose development within the country is essential in the national interest, will deserve protection even if the period of protection has to be somewhat prolonged. Besides, the usual argument that protection should be confined only to deserving industries loses some of its validity in a situation of widespread unemployment and under-employment. In such cases the burden of protection may have to be borne by the community over an extended period simply in order to bring unutilised domestic resources into active use.

Apart from these general arguments against a policy of 'discriminating' protection, the Government of India's policy, as it was worked out during the years 1929–39, came also to be criticised because of its rigid and unsympathetic interpretation of the principles laid down by the Fiscal Commission. For example, a particular industry might be denied protection simply because it lacked one among a number of its raw materials, although instances were not lacking in other countries, notably Japan, where industries were working successfully on imported raw materials. The Fiscal Commission, it appears, did not want that the first principle which it enumerated about the 'natural advantages' of an industry should be interpreted so literally. Logically, too, if the 'natural advantages' enjoyed by an industry were complete in every respect and from the early beginning of the industry, it would be under no need for protection. The Government of India, however, rejected applications for protection on comparatively flimsy grounds and thus brought the policy of 'discriminating protection' into disrepute.

The procedure adopted by the authorities for the grant of protection was unsatisfactory. The Fiscal Commission had recommended a *permanent* Tariff Board to consider applications from industries seeking protection. The Government of India preferred to have a system of *temporary* Tariff Boards set up to consider the case for protection in a particular industry and dissolved it as soon as that case was decided. Such a system not only involved delay in getting the tariff-granting machinery into motion, but also prevented the accumulation of a fund of experience in the tariff authority. Moreover, since each Tariff Board concerned itself only with a single industry, the expansion schemes of different industries could not be synchronised or coordinated. As a result the policy could be blamed for leading to lopsided growth in the industrial field. Certain industries received encouragement no doubt, but other industries intimately related to the former were cold-shouldered. This happened also because the government

rarely took the initiative in the matter of granting protection. Until the industry itself made the first move, the government could remain totally indifferent. This implied, of course, that only established industries could receive the benefits of protection. Industries still in the embryo stage received no attention from the authorities.

In spite of all these limitations, however, the policy of discriminating protection produced some noticeable acceleration in industrial development. The first industry to receive protection was the Steel Industry which was helped in 1924 with both enhanced import duties on steel bars and bounties on the domestic production of steel rails and fish-plates. The protection granted was of the 'safeguarding' type intended to enable the young Indian steel manufacturing units to survive the 'vigorous' competition from the established steel industries of the U.K. and the European Continent. In 1927 and subsequent years similar safeguarding measures were adopted to protect the cotton textiles industry, by no means an 'infant' industry, against unfair competition from Japan and Lancashire. Among relatively new industries which were helped by the policy of protection to get established on a firmer basis than previously may be mentioned: the Paper industry (using bamboo-pulp as raw material) protected in 1925, the Sugar industry protected in 1932, the Matches industry protected in 1928, the Heavy Chemicals industry protected in 1931, the Gold Thread industry also protected in 1931 and the Silk Yarn and Piecegoods industry protected in 1934. Some important Indian industries which perhaps deserved but did not receive protective assistance were Cement, Glass and Petroleum-refining.

The adoption of a policy of fiscal protection by the Government of India brought into prominence the issue of Imperial Preference. Indian public opinion was in favour of levying uniform import and export duties on all goods whatever might be their origin or destination. The policy of Imperial Preference required that preferential treatment should be given to goods coming from or going to Britain and the British Dominions and territories. In 1920 a small measure of Imperial Preference had already been introduced when exports of hides and skins to Britain and British territories were subjected to lower rates of duty than similar exports to other countries. When the Fiscal Commission recommended a protective tariff policy for India, the question of Imperial Preference assumed greater importance. Any preferential treatment for imports of British origin was resisted on the ground that it would reduce the effectiveness of protection and help the British producer at the expense of the Indian consumer. Regarding preferential treatment of goods from British Dominions like Australia or South Africa there was in addition the political argument that so long as these countries maintained their anti-Asiatic attitude in matters of immigration and domicile, India could not be generous in her treatment of their exports.

In spite of opposition, however, the Government of India introduced

measures of Imperial Preference in the tariff legislation of the country during 1924–29. When protective tariff was imposed on steel imports in 1924, lower rates of tariff were imposed on British than on non-British steel. In the case of cotton textiles too, preference was given to goods of British origin by subjecting them to lower rates of import duty.

The Ottawa Imperial Conference of 1932 formally consolidated the schemes of Imperial Preference hitherto in operation and afforded an opportunity to the Empire countries to bargain with Britain for better terms for the entry of their own goods into the British market. An agreement between the Indian and British delegates concluded on August 20, 1932, provided for the duty-free entry of the following classes of Indian goods to the British market: cotton and jute manufactures, tanned hides and skins, rice, tea, coffee, groundnuts, magnesite, magnesium chloride, non-essential vegetable oils, etc. In return, India agreed to grant a 7½ per cent preference to imports of British motor vehicles and a 10 per cent preference to a number of other goods of British origin. Provisions were also incorporated for the grant of preference to cotton textiles and iron and steel products coming from Britain.

In justification of the Ottawa Agreement it was pointed out at the time that only by such specially negotiated bi-lateral agreements could the exports of Indian goods be maintained in the atmosphere of intense competition which the Great Depression had created. To those who pointed out that demand for Indian exports in Britain was in any case inelastic and no useful purpose could therefore be served by such an agreement, the Government's reply was that the agreement was defensive in character, intended to forestall any potential competition that might arise in future in other parts of the British Empire.[2]

The working of the Imperial Preference system under the Ottawa Agreement did not prove satisfactory for India. British exports to India increased substantially, but Indian exports to England increased only to a small extent. The Agreement only caused dissatisfaction among India's other trade partners in Europe and North America. It helped the revival of British industry more than it helped the economy of India. When the Agreement fell for renewal in 1936, the Indian Legislative Assembly vehemently opposed its terms and the Agreement was abandoned. A fresh Indo-British agreement was, however, signed in March 1939 and approved by the Governor-General in spite of an adverse vote against it in the Indian legislature. This agreement considerably narrowed down the range of preferences accorded to British imports. But a trade agreement with Britain was in any case unlikely, in the political circumstances of the day, to be acceptable to public opinion, specially when no attempt was being made to reach a similar understanding with non-British trade partners.

2. See Madan, B.K., *India and Imperial Preference*, 1939.

The fiscal policies of 1923–39 were continued during the years of the Second World War. Conditions were created during the War for the emergence of several new industries as foreign supplies were curtailed to the barest minimum. At the same time, the established industries stretched their productive capacity to the limit to meet the war-time increase in demand.

To encourage new industries which were coming into existence to fill up the vacuum created by the temporary withdrawal of foreign competition, the Commerce Member of the then Government of India announced in June 1940 a significant liberalisation of the fiscal policy then being pursued. The new industries were assured that they would be protected against foreign competition when necessary, provided that the industries were organized on sound lines. This signified a marked departure from the half-hearted manner in which the policy of discriminating protection had been worked before the War. But in a sense the assurance was too sweeping because many of the war-born industries were make-shift affairs and it might be uneconomic to prop them up artificially after the War.

In April 1945 the Government of India set up a special Tariff Board to investigate into the claims of protection of the industries that had come into existence during the War. For the guidance of this Tariff Board the Government laid down two general principles as follows:

(1) the industry to be assisted must be established and conducted on sound business lines, and

(2) either (*a*) that having regard to the natural and economic advantages enjoyed by the industry and its actual or probable cost, it was likely, within a reasonable time, to develop sufficiently to be able to carry on successfully without protection or State assistance;

or, (*b*) that the industry was such that it was desirable, in the national interest, to grant protection or assistance to it and the probable cost of such protection or assistance to the community was not excessive.

Sub-clause (*b*) above was liberal enough to satisfy those who objected against the earlier rigid interpretation of fiscal policy in 1922–23. But while the grounds on which protection could be granted were thus widened, the Tariff Board was not authorised to recommend protection or other assistance for more than three years. This was generally considered insufficient in view of the fact that many of the war time industries needed substantial investment to make them fit for surviving the post-war competition and such investment was unlikely to be forthcoming without the assurance of State support for a longer period.

After the attainment of Independence the Government of India reconstituted the Tariff Board with wider functions and powers. In addition to investigating about industries in need of protection the Tariff Board was also (*a*) to report to the government, as and when required, regarding

factors which led to increase in the cost of industrial production in India, and (*b*) to advise the government, as and when required, regarding measures whereby domestic production could be secured on a more economical basis. Between 1947 and 1950, this Tariff Board carried out a number of tariff and cost investigations, extending tariff protection to over 40 war-time industries which had earlier been given protection for a short period and also discontinuing protection in those cases where the industry had already become reasonably well settled. The cotton textiles, paper and steel industries were de-protected on the recommendations of this Board.

As the list of protected industries grew longer, the Government began to feel the need of keeping the progress of these industries under continuous watch. Accordingly, by a resolution in August 1948, the Government authorised the Tariff Board to conduct enquiries, as and when necessary, regarding the effect of protection or other assistance on the organization and performance of a protected industry and to suggest measures, if necessary, for the modification of the schemes of protection and assistance. At the same time it was being realised that industrial protection, instead of being granted to particular industries in a piecemeal manner, must be conceived as a means to the realisation of an integrated plan of industrial production. The task of formulating anew a comprehensive fiscal policy suited to the changed political and economic circumstances was laid upon a Fiscal Commission set up with eight members in April 1949.

This second Fiscal Commission was presided over by Mr. V.T. Krishnamachari. It submitted its report in 1950. In its report the Commission stressed the necessity of relating the policy of fiscal protection to an overall plan of economic development. In the absence of such a plan, as the experience of the last three decades had shown, industrial development lacks a unity of purpose and the burden of protection is correspondingly enhanced. Pending the preparation of a comprehensive development plan, the Commission suggested that protection should continue to be granted to industries in accordance with the following principles:

(1) Defence and other strategic industries should be protected, whatever the cost of protection may be, on grounds of national interest;

(2) Basic and key industries should be granted protection, subject to terms and conditions which must be complied with by the protected industry and subject to periodical review of such compliance by an appropriate authority; and

(3) In the case of all other industries, the criteria to be applied for granting protection should be that (*a*) having regard to the economic advantages of the industry and its actual or probable cost of production, the industry is likely within a reasonable time to be able to carry on successfully without protection or assistance, and/or (*b*) the industry is such that it is desirable in the national interest to grant protection or assistance to it and,

having regard to its direct and indirect advantages, the probable cost of such protection or assistance to the community is not excessive

The conditions laid down by the second Fiscal Commission were thus much less restrictive than those which the Fiscal Commission of 1921–22 had recommended. In particular, the Commission laid down the principle that the local availability of raw materials should not be a condition precedent to the grant of protection, provided that the industry possessed other significant advantages. Nor was it necessary that a protected industry should eventually be able to satisfy the needs of the entire domestic market: it should be enough if the protected industry could grow to a reasonable size within a reasonable period of time. Besides, industries might be granted protection with an eye to their potential for catering to the export market rather than the home market. In these and other ways most of the constraints of the earlier period of protection were now abandoned.

The Commission also showed its awareness about the need for protecting new and embryonic industries, particularly those where heavy initial capital outlay was involved. The tariff authority, it was recognised, would have to ascertain from the facts at its disposal the prospects which such an industry might have and the competition that it might encounter. On the basis of this assessment, measures of protection or assistance would have to be suggested even *before* such industries had been actually established. It was also recognised that protection to a particular industry which produced raw materials or stores for another industry would, in most cases, call for 'compensatory' protection to the second industry as well if the industrial structure was to be well balanced.[3]

One of the issues referred to the second Fiscal Commission was: how far India could undertake international obligations of the kind involved in the General Agreement on Tariffs and Trade (G.A.T.T.) and the Charter of the International Trade Organization (the Havana Charter) in view of her requirements of industrialisation and export development. The Commission discussed the implications of India's participation in these international institutions and recommended that India should become a member of such institutions for the sake of her commercial interests, but at the same time she should not sacrifice her right to impose restrictions on foreign imports when such restrictions were necessary for her own industrial development. In subsequent years India has pursued the policy of persuading the international institutions to accord special treatment to under-industrialised countries when taking measures for freeing international trade from tariffs, import controls and other restrictions.

On the recommendation of the second Fiscal Commission a permanent and statutory Tariff Commission was set up to make tariff investigations and to undertake cost and price enquiries in specified industries.

3. For other recommendations see *Report of the Fiscal Commission, 1949–50*, Vol. I, Book IV.

11

The Story of Modern Industrial Development in India

In 1818 what is believed to be the first modern industrial factory in India was launched in Calcutta by a group of European capitalist entrepreneurs. It was the country's first cotton mill. In 1830 or thereabouts attempts were made to introduce modern methods of iron-smelting by an Englishman who established his works in Madras. But these early attempts invariably came to grief due to lack of capital and enterprise. British capital was still not eager to seek outlets in India. Domestic capital was not yet prepared to seek profits in modern manufacturing, but preferred the easier and less uncertain returns from commerce and land-holding. Internal communications were poor. The currency and banking system was inadequate for the rise of modern industry. Joint-stock ventures were still unknown. The commercial policies of the East India Company were not particularly helpful for the industrial capitalist, foreign or Indian, seeking to introduce new manufacturing methods into India.

It was only in the decade 1850–60 that stable foundations were laid for the rise of some types of modern industries in the country. Cotton mills began to be established in Bombay after 1854 mainly as the result of the enterprise shown by some Parsi cotton merchants. The first jute-spinning mill came into existence at Rishra near Serampore in (West) Bengal in 1855, while the weaving section of the jute industry started its operations in 1859. Manufacture of leather by the use of modern methods started in 1860 with the establishment of the Government Harness and Saddlery Factory at Kanpur. Machine-made paper was introduced after 1870 when the Bally Paper Mills were founded. In 1874 the Barakar Iron Works started its production of pig iron. Woollen mills came into existence in 1876. The production of matches dates from 1895. Cement manufacturing started in 1904. Behind the rise of all these different industries there was the gradual opening of new coal mines which kept up the supply of industrial power. Beginning in 1820 at Raniganj, coal mining spread to other coalfields until by the beginning of the 20th century the number of coal mines rose to over 300 employing over 85,000 workers. The development of coal mines was, in its turn, facilitated by the construction of railways after 1854. The railways themselves were big purchasers of coal. In addition, they helped the distribution of coal from the mines to the newly-emerging industrial centres.

Some Major Indian Industries

The Cotton Mill Industry

The first cotton mill in India was set up at Ghusuri near Howrah and the first to survive early liquidation was a Bombay mill founded in 1851. The Bombay mill, established by a Parsi merchant, Cowasji Nanabhoy Davar, became the pioneer of similar enterprises in that region and the radiating point of modern cotton textiles manufactures in India. By 1875 there were 48 cotton mills, most of them in the Bombay region, with about 10,000 looms and 1 million spindles. The majority of these mills had both spinning and weaving units. For some time in the early years the industry was handicapped by the sharp rise in the price of cotton, caused by the Civil War in the United States. The termination of the Civil War brought down cotton prices to a more reasonable level and the cotton mill industry started spreading to inland centres like Ahmedabad, Nagpur and Sholapur situated in the heart of the cotton-growing tract of India. By 1882 the number of mills rose to 62, total loomage to 15,116 and spindleage to 1.65 million. The authorised capital in the industry in that year was estimated as Rs. 6.37 crores (Rupee Companies) plus £80,000 (Sterling Companies) and over 53,000 persons were employed.

The development of the cotton-mill industry in India had its repercussions on Lancashire. Indian imports of cotton twist and yarn ceased to expand in the 1870s and, although imports of manufactured cotton goods were still increasing, India had begun to export coarser varieties of cotton cloth in larger amounts. As the Government of India, pressed by heavy financial needs of the Indian Mutiny and other military activities, had found it necessary to enhance import duties, Lancashire interests picked on the cloth import duties as the villain of the piece, suggesting that these were exercising a protective influence giving a differential advantage to the cotton mills in India. The British Parliament, still wedded at this time to undiluted free trade principles, accepted Lancashire's plea, although it was repeatedly pointed out at the time that the varieties of cloth produced by the Indian industry were not directly competitive with Lancashire products. In March 1879 import duties on certain coarser varieties of cloth were taken off by the Government of India at the behest of the British Government. This was followed, in 1882, by a total repeal of all import duties.

The repeal of import duties did not have any noticeable effect on the expansion of cotton mills in India. The number of mills increased steadily and, with the introduction of new types of mill machinery after 1885, the production of finer counts of yarn and superior varieties of cloth also became possible. By 1895 the number of cotton mills had risen to 138, looms numbered 29,392 and spindles installed had reached 3.5 million. Indian

yarn was making serious inroads into British sales of yarn in China.[1] By 1903–04 another 68 mills had come into existence. The number of looms and spindles was increasing all the time, looms increasing at a slightly faster rate than spindles. Japan which was a purchaser of Indian yarn was at this time developing her own production of cotton yarn. Besides, the domestic demand for cloth was on the increase so that a larger proportion of the yarn began to be used for cloth production at home. Of the 206 mills in 1904, 113 were exclusively devoted to spinning, 5 exclusively to weaving and the rest were composite mills. Nearly 186,000 persons were then employed in the cotton mill industry.

Towards the end of the nineteenth century cotton mills in India began to face a number of problems. The plague epidemic (1896) in Bombay gave rise to a scarcity of labour and a rise in wages. In 1900 the failure of the cotton crop due to drought created difficulties about raw material supplies, while famines in the closing years of the century reduced the off-take of cloth in the domestic market. Political disturbances in China, coupled with fluctuations in exchange rates between the Indian and Chinese currencies, led to a slowing down of Indian exports to China. In 1902 the American cotton speculation drove cotton prices up, causing a shrinkage of profits for Indian cloth mills. In 1895 when import duties were re-imposed on British yarn and cotton goods, the Indian Cotton mills were subjected to the levy of a "countervailing" excise duty so as to neutralise any competitive advantage they might otherwise have over their British counterparts. But these difficulties were met by the industry by introducing some essential measures of reorganisation which helped its further expansion. By 1913–14 there were 264 mills employing over 266,000 people. Looms and spindles numbered 96,688 and 66,20,576 respectively. The capital invested in the industry stood at Rs. 21.5 crores plus £636.3 million.

With the outbreak of World War I India lost some important markets for her exports of cotton yarn and piecegoods. Mill machinery and mill stores could not be secured from England which was engaged in an all-out war. The number of cotton mills, in fact, declined marginally during the War. In 1919–20 there were 263 mills against 267 in 1915–16. The number of spindles declined from 6.68 million in the latter year to 6.50 million in 1918–19. But the number of looms increased steadily even during the war years.[2] At the end of the war more than 3 lakh operatives were at work in the cotton mill industry. During the war years the diminution in the export trade in yarn gave an impetus to the expansion of cloth production for the domestic market. Cloth production steadily increased from 1135.7 million

1. Indian export of twist and yarn rose from 26.7 million lbs. in 1879-80 to 170.52 million lbs. in 1890-91.

2. In 1896 there were 106 spindles per loom; in 1935 the number of spindles per loom had fallen to 49. See Dam, M.L. in Mukherjee and De: *Economic Problems of Modern India*, Vol. 2, p. 34.

yards in 1914–15 to 1614.1 million yards in 1917–18. Imports of piece-goods were declining during this period and domestic prices were rising, creating conditions favourable for the expansion of the weaving section of the mill industry. But owing to its dependence on foreign machinery and mill-stores the industry could not take full advantage of this situation.

In 1921 when revenue considerations led the Government of India to raise the import duty on cotton piecegoods to 11 per cent , the "counter-vailing" excise duty was maintained at its old level, *viz.*, 3.5 per cent with the result that the Indian mill industry began to receive an effective protection of 7.5 per cent. In spite of this advantage vis-a-vis the British producers the industry entered a prolonged phase of depression after 1923. The emergence of Japanese competition after World War I, the rise in the prices of cotton and of imported mill stores after 1920 and the fall in the purchasing power of agriculturists after 1921–22 were some of the factors that brought about this depression.

During this period of depression the Bombay mills suffered more in comparison with the mills in the inland centres. There were several reasons for this. The Bombay mills had come into existence in the early years of the development of the industry and were equipped for the production of the coarser types of yarn and cloth. With the change in market conditions both at home and abroad, the production of these varieties had become less profitable than the production of finer varieties for which the newly established inland mills were better equipped. Moreover, the advantages in transport costs which the Bombay mills enjoyed, so long as they relied on export markets for their products, were gradually coming to an end as the home market began to have a larger say in the fortunes of the industry. These factors explain why, side by side with some decline in the profits of Bombay mills, additional units in the cotton mill industry were simultaneously coming into existence in the relatively new inland mill centres.

The industry was considered for protection in 1926 on the representation of Bombay mill-owners. The Tariff Board which enquired into the matter, while suggesting certain measures to improve the competitive position of the Bombay section of the industry, also recommended the raising of the import duty on all cotton goods from 11 to 15 per cent. Its recommendations also included bounties on the spinning of higher counts of yarn and exemption from tariff for all imported mill machinery and stores. The Government of India at first turned down all these recommendations except the last, but on further representation from the mill-owners agreed to change the duty on cotton yarn from 5 per cent *ad valorem* to 1½ annas per lb. or 5 per cent whichever was higher. This revision was given effect to by the Indian Tariff (Cotton Yarn Amendment) Act of 1927.

The measures adopted failed to bring about any substantial improvement in the situation and demand for more effective protection became insistent. In July 1929, the Government of India appointed Mr. G.S. Hardy, Collector

of Customs, Calcutta, to go into the question once again. On his recommendation, the Government adopted in 1930 the Cotton Textile Industry Protection Act which raised the general *ad valorem* duty on cotton goods to 15 per cent on British goods and 20 per cent on non-British goods. At the same time the Act provided for a minimum specific duty of 3½ as. per lb. on all plain grey goods, British or non-British, since the Bombay mills had been facing stiff competition from Japan in these particular varieties of cloth. These duties were to remain in force up to 31st March, 1933. In 1931, however, the amount of protection afforded to the industry was further stepped up. After two revisions in March and November that year, the *ad valorem* duty stood at 25 per cent and 31¼ per cent respectively on British and non-British goods while the minimum specific duty on plain grey goods was raised to 4⅜ as. per lb.

In April 1932 a Tariff Board for the cotton mill industry was set up for the second time to go into the question of continuance of protection to the industry after March 1933. Japanese competition was still very severe owing to the continued depreciation in the exchange value of the Japanese currency (*yen*). The Board was, therefore, asked to carry out an emergency inquiry in July 1932. On its recommendation the *ad valorem* duty on non-British piecegoods was raised from 31¼ to 50 per cent and the minimum specific duty on plain grey goods to 5¼ as. per lb. Effect was given to these revised rates in August 1932. Ten months later, in June 1933, the *ad valorem* duty was further raised to 75 per cent and the specific duty to 6¾ as. per lb.

Excessively protective measures against the Japanese cotton manufacturers began, however, to affect the sale of Indian raw cotton to Japan. Hence trade negotiations with Japan were opened. In January 1934 an Indo-Japanese Trade Agreement prescribed a system of quotas for the imports of Japanese cloth into India and the export of raw cotton from India. Japan was allowed to sell in the Indian market 325 million yards of cloth in any particular year provided that she purchased 1 million cotton bales from India. For every 10,000 additional bales of raw cotton imported, she could export to India 1½ million yards of piecegoods, subject to an absolute maximum of 400 million yards per year. After this agreement was drawn up, the tariff rates on non-British piecegoods were reduced to 50 per cent *ad valorem*, subject to a minimum of 5¼ as. per lb. on plain grey cloths.

Similar agreements were concluded by the Indian cotton interests with the Lancashire textile industry in 1933 and 1934. On the basis of the understanding reached in these agreements, *ad valorem* duties on British goods were reduced in 1936 from 25 per cent to 20 per cent and the minimum specific duties from 4⅜ as. per lb. to 3½ as. per lb. In 1939 a new Indo-British Trade Agreement permitted the import duties on British goods to be reduced further to 17½ per cent on printed goods, 15 per cent on other goods and a minimum of 2 annas 7 pies per lb. on plain grey goods. The

Agreement of 1939 provided for a minimum quota of 350 million yards of British textile imports into India. If imports fell below this quota the duties were to be reduced by 2½ per cent, while in the event of imports exceeding 500 million yards the basic duties could be raised. Sales of Indian raw cotton in the British market were guaranteed to the extent of 6 lakh bales per year.

The Second World War created conditions favourable for the industry's expansion. Production of cotton cloth increased from 4012 million yards in 1939–40 to 4870 million yards in 1943–44. Protection granted to the industry since 1927 was allowed to expire with effect from March 31, 1947.

On the eve of Independence there were 422 cotton mills in the country. Only 14 of these were located in territory incorporated in Pakistan, 9 in the eastern wing and 5 in West Pakistan. After partition nearly 95 per cent of the spindleage and loomage remained in the Indian Union. The raw cotton requirements of the cotton mills in the Indian Union were estimated at 4.5 million bales (1 bale 400 lbs.), but domestic production of raw cotton was only about 2.2 million bales. Apart from shortage of raw materials the mills also carried a backlog of worn-out machinery and badly needed technological renovation.

The Jute Mill Industry

Jute was the basis of a hand-spinning and hand-weaving industry in Bengal from very old times. Ropes and gunny cloth were the main articles turned out by this handicraft industry, almost every farming family producing some jute on its land to meet its requirements of such articles. As an export article, raw jute began to figure in our foreign trade accounts from the last decade of the 18th century, but the quantities exported remained small for many years in the beginning. Technical difficulties of bleaching and dyeing stood in the way of extensive use of jute as a material in modern industry. These technical difficulties were not surmounted until about 1838 when a number of jute mills sprang up in and around Dundee in Scotland, creating larger demand for raw jute in the United Kingdom. The demand for raw jute received further boost in the 1850s when supply of Russian flax and hemp to Britain was cut off by the Crimean War.

In India jute mills came to be established in the 1850s. The credit for establishing the first jute mill goes to an ex-official of the British Merchant Navy, George Acland, who set up his jute-spinning mill at Rishra on the Western bank of the river Hooghly in 1855. The first jute-weaving mill based on steam power was established at Baranagar, near Calcutta, in 1859. Since the demand for jute cloth as a packing material was expanding with the growth of world trade, the jute mills found a ready market for their products. But difficulties of financing and procuring the requisite machinery prevented a rapid expansion. By 1873 only 5 jute mills had come into exis-

tence with a meagre 1,250 looms. Between 1875 and 1900 there was considerable expansion in loomage, the numbei of looms in 1900 rising to over 15,000. Between 1900 and 1913 loomage again increased by 135 per cent. From the very beginning the indigenous jute industry faced the competition of the already established jute industry of Dundee. But the superior advantages enjoyed by the Indian industry in the form of cheaper raw material and labour as well as the lower level of taxes enabled the Indian industry to survive in competition and earn comparatively high profits (as compared, say, with coal mines or tea plantations). In fact, by 1894 the raw jute intake of the Indian jute mills was already higher than that of its British counterpart. British industry, however, registered a superior level of efficiency. One evidence of this superiority was that its output of jute goods continued to surpass the Indian output in spite of its lower consumption of raw jute. Indian output of jute products surpassed British output in 1908. At this time Germany and the U.S.A. were also developing their own jute mills under tariff protection. Their policy generally was to manufacture gunny bags out of imported Indian hessian, so that the main effect of foreign competition was to reduce the relative importance of sacking to hessian production in the Indian jute mills.

Even when the productive capacity of jute mills in India was on the increase, the problem of unused capacity recurrently arose, since the demand for jute goods fluctuated from year to year depending on the volume of world trade. The persistence of surplus capacity is also attributable to some extent to the quasi-monopolistic organisation of the jute mills. In 1884 they formed themselves into the Indian Jute Manufacturers' Association (name later changed to Indian Jute Mills Association) which generally tried to maintain high profit levels by working shorter hours or sealing a percentage of looms. The earliest instance of a short-time arrangement was in 1886 while sealing of looms was resorted to for the first time in 1890. Thanks to this quasi-monopolistic organisation of the industry, profit rates of 60 to 70 per cent were not uncommon in this industry. It appears that new entry into the industry was somewhat slowed down after the formation of the I.J.M.A., new mills being allowed to be established mainly by the already established concerns.

During the First World War there was an enormous increase in the demand for jute goods, particularly for sand bags. There was a doubling in the value of exports of jute manufactures between 1914–15 and 1918–19, but very little expansion in the size of the industry. Profits rose to unprecedented heights. But the prosperity of the industry did not lead to any substantial improvement in the condition of raw jute growers. The exports of raw jute were subject to war-time controls imposed largely in the interests of the mills. Prices of raw jute declined substantially as the foreign demand for raw jute dwindled away during the war years.

Immediately after the war the demand for jute goods was kept buoyant

by the heavy movement of foodgrains to the war-devastated European continent. The war boom continued up to 1921–22, but in that year the value of exports fell by as much as 44 per cent. However, while the abnormal war demand was thus falling off, the normal increasing trend in demand continued. In response to this, the number of jute mills increased in the 1920s from 81 to 98, the loomage from 43,025 to 53,900, the spindleage from 9 lakhs to over 11 lakhs and the number of workers from 2.88 lakhs to 3.43 lakhs.

The restriction on working hours which had been prevalent since April 1921 (54-hour week) was given up on 1st July, 1929 (60–hour week). But the change in policy was ill-timed as the world-wide depression very soon led to a sharp decline in the demand for both raw jute and jute manufactures. The rate of profit in the industry declined. Between 1930–31 and 1933–34 there was, in fact, a decline in the number of mills, in spindleage and loomage. The position changed for the better only after the Second World War broke out, the year 1938 being one of the worst in the annals of the industry.

During the depression the production of jute goods continued to record a slow expansion because (*a*) the volume of world trade fell less than its value: after 1932 the volume was recovering, reaching almost the pre-depression level in 1937, and (*b*) the I.J.M.A. adopted a policy of restricted growth in its search for higher profits: working hours were reduced to 54 per week with effect from 1st July, 1930 and to 40 per week from March 1931. Subsequent agreements led to closure of mills one week in each month and sealing of 15 per cent of the looms. Not all mills, however, were members of the Association. Their competition posed problems for the success of the Association's policies. Costs of production were reduced by a cut in wages, but more importantly by a fall in the price of raw jute, brought about by the general depression as well as by the shorter working hours of the jute mills. The price of raw jute recovered to some extent after 1936 because of measures adopted for restricting the acreage under jute.

During the Second World War the demand for jute revived and profits in this industry over-stripped the rate of profit in other Indian industries. By 1942–43 the number of mills rose to 113, loomage to 67,774 and spindleage to 13.75 lakhs. In the middle of December 1939 the jute mills were exempted from the Factories Act to enable them to work 60 hours a week. But this exemption was not taken advantage of by the mills except for short spells. The usual working hours remained 54 per week, sometimes reduced to 50 or 45 in accordance with the I.J.M.A.'s estimate of expected demand. There were also factors operating to limit the demand for jute goods, *viz.*, loss of European markets during the war and lack of shipping space.

In the immediate post-war period prosperity continued for the first two years. Then came Independence and the partition affecting severely the fortunes of the industry.

As a result of the partition while the bulk of the raw jute supply went to Pakistan, the jute mills remained in India.[3] The difficulties in obtaining a steady supply of raw materials, the emergence of new competition from jute mills in Pakistan and elsewhere and the dwindling demand for jute as a packing material—all these created grave problems for the jute industry in the post-independence period. The Korean War (1950) brought about only a temporary spurt in demand and prices.

The installed capacity in the industry has remained practically unchanged at 1.2 million tons. The I.J.M.A. agreements have stood in the way of any increase in loomage above pre-war levels. Working hours as well as the percentage of looms sealed have fluctuated in response to the prevailing state of the market for jute products.

The search for substitutes of jute products in packing was accelerated during and after the Second World War by the high prices of jute manufactures. While the index of use of jute in the U.S.A. fell from 100 in 1940 to 83 in 1954, the index for paper rose from 100 to 407. India's relative position has also suffered a decline. In the years immediately preceding the Second World War India produced about 60 per cent of total world output of manufactured jute; in 1953–54 this share fell to 55 per cent. The proportion of Indian exports to total exports fell from 89 to 86 per cent. Certain varieties of jute products sold in the U.S. market, formerly regarded as India's close preserve, came to be supplied by Continental and Pakistan mills in the post-independence period.

The Iron and Steel Industry

Attempts to introduce European processes of iron smelting in India started in the early years of the nineteenth century. The name of Josiah Marshall Heath, a retired Madras civilian and a friend of the famous English novelist, Charles Dickens, is associated with these pioneering efforts in the iron industry. Heath is reported to have established an iron works in

3. Only 25 per cent of the raw-jute producing area of undivided India remained inside the Indian Union. The raw material requirements of the industry were estimated in 1950–51 as 7 million bales while in that year internal supplies were only about 3.1 million bales. The production of raw jute in the Indian Union rose by almost 100 per cent between 1947–48 and 1950–51, but quality of the jute produced, often on unsuitable soil, was not up to the mark. In 1957 the Government of India set up a Jute Enquiry Committee to investigate the problems of supply of raw jute for Indian mills. They advised that self-sufficiency in jute was both desirable (as Pakistan would tend to raise prices against India) and practicable. The Government switched over to a "grow more jute" campaign. The possibilities of increasing acreage under jute without affecting the output of paddy was necessarily limited. The emphasis on extension of jute area has led to cultivation of inferior lands and sometimes to deterioration in quality of raw jute. In later years more stress has been given to improvement in quality through better seeds, improved techniques and concentration of effort on areas producing superior varieties.

South Arcot in 1830 under a grant from the East India Company. His experiments proved unsuccessful and after his death his works were acquired by the East India Iron Company in 1853. This Company established two blast furnaces in South Arcot and started similar works on the Malabar coast. The outcome of its efforts was not altogether successful and the Company had to abandon its works in 1874.

At the same time efforts were going on in the Bengal Presidency to set up a modern iron works. The early efforts did not prove very rewarding. The Barakar Iron Works, established in 1875, had to close down in 1879. The Government took over the Works in 1881 and after operating it for over eight years handed it over to the Bengal Iron and Steel Company Ltd. Its annual outturn was about 35,000 tons of pig iron in the early years of the present century. In 1905 the Company opened a Steel section, but steel production proved uneconomical because of competition from cheap European steel. The Steel section was closed after one year, but the annual production of pig iron expanded by the beginning of the First World War to 120,000 tons. Towards the end of 1919 a new company, called the Bengal Iron Company, was incorporated to take over the assets of the Bengal Iron and Steel Company. This new firm renovated the undertaking and was equipped to raise the output of pig iron to double its previous level.

The Tata Iron and Steel Company was registered in August 1907 and established its works at Sakchi (re-named Jamshedpur after World War I to commemorate its founder, Sir Jamshedji Tata) in 1908. The coke ovens and the blast furnace became ready for operation in 1911. At first pig iron alone was turned out, but by 1913 steel production was also being undertaken on a regular basis. The first piece of ingot steel was rolled out in February 1912 and the first steel rails were turned out in March 1913. By 1920 the steel producing capacity rose to 2 lakh tons per annum.

Attracted by the success of Mr. Tata's efforts the Indian Iron and Steel Company was floated in 1918 by Messrs. Burn and Company. The Company's works at Hirapur started producing pig iron in 1922. The United Steel Corporation of Asia was registered in 1921. A number of other iron and steel companies also came into existence in the years after the First World War. Among them they were estimated to have an annual capacity of 1.5 million tons of pig iron and 1 million tons of steel.

The First World War was responsible to a large extent for the success which attended the iron and steel industry at its inception. The cessation of steel imports during the war left the field open to indigenous manufacturers. The Tata Iron and Steel Works received considerable help in its ventures by the Indian Railway Board's offer to take annually for ten years 20,000 tons of steel rails from the Company.

After the termination of the First World War the European steel industry, with its capacity considerably expanded during the War, began to compete vigorously with the new-born steel industry of India. The Tata works,

which had undertaken a scheme of expansion for the post-war period, was seriously handicapped by this competition and applied for fiscal protection. The Tariff Board reporting on the iron and steel industry in 1924 recommended the grant of protection to the industry in the form of higher import duties as well as bounties on certain categories of products (*e.g.*, heavy steel rails, fishplates and railway wagons). The iron and steel industry was the first recipient of State assistance under the policy of discriminating protection adopted by the Government of India in 1923.

In consequence of the grant of protection to the iron and steel industry the engineering industry, which depended on iron and steel as raw materials, had also to be protected by higher import duties on certain types of fabricated steel. New forms of engineering enterprises were coming into existence in and around Jamshedpur which deserved protection in the short run. The Tariff Board was of the view that, given India's abundant supply of iron ore and other key materials and the potential supply of skilled labour, the engineering industry had a reasonably bright future in this country.

The iron and steel industry was protected initially for three years. In 1926 a second enquiry was carried out by a Tariff Board and renewal of protection was recommended. In 1927 the industry was granted protection for seven years, with different rates of duty being imposed on standard and non-standard steel.

As standard steel was imported mostly from Britain, such differentiation actually implied preference for British steel. Indian public opinion was opposed to Imperial Preference in any form and the bill embodying different rates of duty for different types of steel was vehemently opposed in the Indian legislature. The measure was, however, enacted in the form in which the government wanted it. Several years later, after the Ottawa agreement of 1932, the scale of preferences on British steel goods was revised and the duration of protective tariffs was extended up to the end of October 1934. In that year a Tariff Board once again reviewed the competitive position of the iron and steel industry and recorded that in certain categories of products protective duties could be considerably reduced. The Government of India, accordingly, revised downwards some of the import duties on protected items of steel. As this would involve the Government in financial losses, excise duties were imposed on the production of steel ingots in the country to make good the losses. Between the years 1923 and 1939 there was an almost eight-fold increase in the production of steel ingots.

On the outbreak of the Second World War iron and steel prices came to be controlled by the Government. Increases in the cost of production were, however, taken into account in fixing the price, and a return of 8 per cent on the block capital was allowed. The growth of the industry made

protective duties unnecessary after the War and these were discontinued with effect from April 1, 1947.

The Second World War brought about a considerable increase in the demand for iron and steel in the country. The industry responded by raising the output of steel ingots from 1 to 1.34 million tons, but since productive capacity could not be expanded during the war, the additional production was obtained simply by straining the capacity in existence. In the post-war period this created problems of rehabilitation of plant and machinery. Expansion schemes were also taken in hand by the units concerned immediately after the war ended. The Iron and Steel Panel set up by the Government of India, which examined the prospects of the steel manufacturing industry in India in the post-World War II period, estimated domestic requirements of finished steel at 2 million tons per annum. As more and more public construction projects have been planned, this estimate has been continually revised upwards. On completion of the expansion schemes already taken up by the main steel producers in the country before the initiation of the First Five-Year Plan, the capacity of the industry was expected to go up to 1.65 million tons by 1957–58.

The Sugar Industry

Indigenous methods of manufacturing sugar from cane were in use in India from very ancient times. The sugar turned out by such methods was not, of course, as refined as the sugar produced in today's sugar mills, but apparently a large demand existed for Indian sugar in many countries of Asia and Europe. The East India Company exported sugar from Bengal for many years until the British Government, as a matter of policy, decided to accord preferential treatment to sugar grown in the West Indies.

European methods of sugar refining were introduced in India about the middle of the nineteenth century. But the domestic demand for sugar was growing by leaps and bounds, encouraged by the fact that foreign sugar could be obtained in India at a price that compared favourably with the domestic cost of sugar production. After 1863 India became a net importer of sugar, the main source of supply being Mauritius where British planters had built up a cane sugar industry with the help of indentured Indian labourers. Towards the end of the nineteenth century European beet sugar, specially from Austria and Germany, also began to be imported in large quantities. It was reported that the beet sugar was being unloaded on the Indian market with the help of special bounties and in 1902 the Government of India took action to stop such imports by imposing a duty on imported beet sugar at a rate intended to neutralize the effect of bounties. This was the first instance of government's intervention with trade after free trade had been declared as official policy in the 1870s. But the intervention was primarily in the interest of British sugarcane planters

in Mauritius whose exports to India had been adversely affected by the short-lived competition of European beet sugar. The International Sugar Conference, meeting in Brussels in 1901–02, decided in favour of abolition of all kinds of bounty and import duty on sugar; consequently the European countries withdrew their bounties on sugar exports and the Indian import duty on bounty-fed beet sugar was also taken off in 1904. Just before the First World War imports of sugar from Java increased remarkably, as the sugar industry in Java turned to the Indian market after having lost the US market to Cuba which became the most preferred supplier in the American market under a bi-lateral agreement between the U.S.A. and Cuba.

The First World War brought about a world-wide scarcity of sugar as the production of European beet sugar was hampered by the war. In India the price of sugar rose to unprecedented heights. But owing to difficulties of installing new capacity the sugar industry did not expand. Sugar prices continued to rule high until 1924 when world supply once again began to overtake demand and low-priced imports started pouring into India.

A revenue duty on sugar imports was introduced in 1894, the rate of duty being 5 per cent *ad valorem*. During the First World War, revenue considerations led to an increase in the duty on sugar to 10 per cent. The duty was further raised in 1921 (15 p.c.) and 1922 (25 p.c.) in a frantic attempt to meet the budget deficits in the early twenties. In 1925 the duty on sugar of superior quality was converted into a specific duty at the rate of Rs. 4.50 per cwt. which, at the then prevailing prices of sugar, amounted to about 30 per cent *ad valorem*. The specific duty was raised to Rs. 6 per cwt. in 1930. But as sugar prices fell head-long in the depression even this high rate was unable to check the growth of imports.

A Tariff Board was constituted in 1931 to study the condition of the domestic sugar industry in the light of existing foreign competition. The Board recommended that the sugar industry deserved a protective tariff for a reasonably long period, say, 15 years, to enable the industry to face foreign competition on equal terms. The Board also recommended steps for the improvement of the quality of Indian sugar-cane and for safeguarding the interest of the cane growers.

The existing revenue duty on sugar had been raised to Rs. 7.25 per cwt. in the budget for 1931–32. In pursuance of the above recommendation of the tariff board on the sugar industry the Government of India converted the revenue duty into a protective duty by adopting the Sugar Industry Protection Act in 1932. Continuance of the existing rate of duty was assured for six years, *i.e.*, up to March 31, 1938. If the market price of imported sugar fell below Rs. 4 per md the Government armed itself with power to provide additional protection.

The high rate of protective duty, specially after the imposition of a revenue surcharge of 25 per cent on the prevailing rate in September 1931, brought about a sudden fall in sugar imports and a rush of domestic invest-

ment in sugar factories. The number of sugar factories went up from 32 before the grant of protection to 145 immediately before the Second World War and domestic output of refined sugar rose from 151.7 thousand tons to 1,350 thousand tons. To curb unhealthy expansion as well as to make good the loss of revenue resulting from the fall in sugar imports, the government subjected sugar to an excise duty in 1934. The duty was enhanced in subsequent years.

An enquiry by a second Tariff Board in 1937 led the government to continue protection to the sugar industry beyond 1938. The rate of duty was fixed at Rs. 6.75 per cwt. exclusive of the countervailing import duty at a rate equivalent to the prevailing excise duty. Protection was withdrawn from the sugar industry in April 1951 on the ground that eighteen years of protection had created a spirit of complacency in the industry and it must now be left to face competition by improving efficiency.

Under the Central Sugar-Cane Act, 1934, the Provincial governments were authorised to fix minimum prices for sugar-cane purchased by the factories from cane-growers. The governments of U.P. and Bihar adopted schemes for regulation of cane prices under the provisions of this Act. The Government of India also instituted a fund to be utilised to assist the formation of cane-growers' co-operatives which would help farmers to secure fair prices for their sugar-cane crop.

Research for improving the quality of sugar-cane which had been initiated in 1901–02 was stepped up after 1932. In 1938 research came to be financed partially by an allotment of 3 as. per cwt. from the sugar excise. The cane-breeding station at Coimbatore has done useful work in improving the varieties of sugar-cane grown in India, while the Institute of Sugar Technology at Kanpur has evolved a number of new methods to improve the extraction of sugar from the cane.

Excessive competition among themselves forced the sugar mills in 1937 to embark upon joint marketing arrangements by establishing a Sugar Syndicate. This helped in checking a fall in sugar prices to uneconomic levels in the period 1937–40 after which war-time conditions led to a sharp rise in prices. In 1942 sugar prices were subjected to statutory control which continued into the post-war years except for a brief period of decontrol in 1947–49. During this period of de-control the Sugar Syndicate played a nefarious part in artificially raising sugar prices for which it was roundly condemned by a tariff board in 1950. The Syndicate went into voluntary liquidation in March 1950.

India not only became self-sufficient in sugar as a result of the grant of protection, but after 1936 was also in a position to export to neighbouring countries at a competitive price. But under the terms of the International Sugar Convention of 1937 the Government of India bound itself not to undertake any exports, except to Burma, in the next five years. This restriction was temporarily waived in 1940 to enable India to export much-

needed sugar to the United Kingdom, but the exports did not materialise as the two countries could not agree in regard to prices. In 1942–43 some sugar was exported to the Middle East. After the lapse of the Sugar Convention India was hardly in a position to export any sugar, domestic demand having by that time expanded so as to surpass domestic production. Rising domestic costs of production also stood in the way of expansion of exports.

The sugar industry in India suffers from a number of handicaps which ought to be removed as early as possible to improve its working. In the first place, the sugar-content of Indian cane is low by world standards and, therefore, Indian mills have a larger crushing cost per unit of sugar turned out by the mills. The quality of sugar-cane grown in India has to be brought up to the standard of other countries to enable Indian sugar mills to give a good account of themselves. Secondly, most of the mills are located in U.P. and Bihar although cane of a superior quality can be grown at a lower cost in the southern States. This uneconomic location of the industry tends to keep the cost of production of sugar rather high. Thirdly, the cost of sugar production is also kept high by the inadequate utilisation of such by-products as molasses (utilisable for manufacture of alcohol) and *bagasse* (utilisable for paper manufacture).

In 1947–48 there were about 135 sugar factories in India (compared with only 10 factories in Pakistan) employing nearly 120,000 workers. The sugar industry being seasonal in its nature, most of the workers obtained employment for only six to eight months in a year. Capital investment in the sugar industry was estimated at Rs. 35 crores before 1950. *Per capita* consumption of sugar in India is one of the lowest of all countries being only about 6 lbs. per year as compared to 106 lbs. in the U.K., 97 lbs. in the U.S.A. and 52 lbs. in France. Poorer people, specially in rural areas, generally use *gur* (jaggery) which is extracted by simple boiling of the cane juice without removal of the molasses. Taking into account the consumption of *gur*, the *per capita* consumption figure would be about 24 lbs. per year. Production of factory-refined sugar in India stood at about 10 lakh tons in 1948–49.

Other Selected Industries in Brief

The Paper Industry

Hand-made paper was in use in India but machine-made paper was introduced with the establishment of the Bally Mills on the Hooghly river in 1870. In 1882 the Titaghur Paper Mills was set up followed in 1893–94 by the Imperial Paper Mill at Kakinara. These mills worked on imported wooden pulp or pulp made of *Subai* grass. The use of Indian bamboo pulp for the manufacture of paper was introduced in Bengal by the Indian Paper Pulp Company formed in 1918. Paper mills also existed in Lucknow since

1879 and in Poona since 1887. The use of straw from Indian paddy for the manufacture of paper began in the Carnatic Paper Mills which started operations in Andhra in 1927–28. On the eve of the Second World War 11 paper mills were in existence of which there were 4 each in Bengal and Bombay, and one each in U.P., Madras and Travancore. Production of mill-made paper stood at 11.84 lakh cwt. in 1938–39.

The growth of the paper mill industry was helped by the protection it received in 1925. The Bamboo Paper Industry (Protection) Act of that year provided for the levy of a protective duty of 1 anna per lb. on certain varieties of imported paper which were in competition with bamboo-made Indian paper. Initially the protection was granted for 7 years but on the basis of further enquiries by Tariff Boards in 1932 and 1937 protection was continued until it was withdrawn in 1947 as the industry no longer called for protection. During this period raw material supplies had improved and the cost of production had been substantially brought down. On the eve of Independence India had 16 paper mills with an annual production of about 20 lakh cwts. In spite of a remarkable expansion in domestic production imports of paper and board were rising as the demand for writing material increased with the spread of literacy, the proliferation of administrative establishment during the war and so on. Besides, India is still not in a position to manufacture certain kinds of high quality paper which have to be obtained through imports.

The paper industry suffers from the high cost of some of its inputs such as chemicals and fuel. After the partition the industry also faced an acute shortage of supply of its principal raw materials, some of which have to come from or through the eastern wing of Pakistan. However, this problem has been solved to a large extent by the development of alternative sources of supply.

The Leather (Tanning) Industry

The huge livestock population of India could have been the basis of a flourishing leather industry, but until recently most of the hides and skins have been exported in the raw or semi-finished state. Indigenous processes of leather-making, using locally available curing and tanning materials, were used to supply the requirements of saddlery, etc., required in the Middle Ages, but superior leather began to be turned out with the help of imported chemicals only after the establishment of the Government Harness and Saddlery Factory at Kanpur in 1860. Several other factories sprang up in different parts of the country, but only the European factories made adequate use of modern processes, the Indian tanneries continuing to use the antiquated methods. Tanning of cow-hides received an impetus during the First World War when the Indian Munitions Board discovered the use of such hides for the manufacture of British army-boots. The manufacture of other kinds of leather goods also rose during the war. The annual

production of boots and shoes in India expanded almost twenty times in the course of that war.

Chrome tanning processes, used in the manufacture of superior leather, were, however, slow to take root. The Madras Government made commendable pioneering attempts to introduce 'chrome tanning' in the leather industry in that province during 1903–11, but had to abandon its innovational role when Chambers of Commerce voiced their apprehension of government 'intervention' in industry. After that progress was slow, largely because neither the skill nor the equipments necessary for the wide adoption of improved processes were available.

The domestic tanning industry received some relief in 1918–19 when the Government of India imposed an export duty on raw hides and skins at the rate of 15 per cent *ad valorem* on exports to countries outside the British Empire with a 10 per cent rebate on exports to countries within the Empire. This was a method of giving protection to industry by hurting the interests of the primary producer and was discountenanced by the Fiscal Commission in 1923. The export duty was reduced to 5 per cent in that year and the rebate in favour of Empire countries was given up. In 1934–35 the export duty was altogether abolished.

The industry further expanded during the Second World War. But after 1942 scarcity in the supply of raw hide stood in the way of more rapid expansion. The industry also suffered from a shortage of equipment and skilled manpower.

The Glass Industry

The manufacture of glass was not unknown to India before the European advent but the process used resulted only in crude glass which was used for the manufacture of bangles and bottles. Several glass factories using more up-to-date processes of production came to be established in the last decade of the 19th century, but competition from superior European wares led to their decay. The Swadeshi movement[4] gave a fillip to the starting of small glass factories to replace English glass-ware and a few factories organised on a small scale struggled for existence against foreign competition until suddenly the First World War, by cutting off imports, created conditions favourable for their survival. Orders placed by the Indian Munitions Board helped the glass factories to diversify their production and improve the quality of the products. After the war glass imports increased again and a tariff board which investigated the conditions of the glass industry in 1931 recommended protective duties to certain glass products for a period of ten years. The Government of India,

4. A political movement against the British rulers using the weapon of economic boycott of British goods, which swept Bengal (then the headquarters of the Government of India) during 1905–1908.

however, turned down this recommendation on the plea that the raw materials required for glass manufacture, soda ash in particular, were not available in adequate quantities in India. Some relief was granted by reducing the import duty on soda ash and an assurance was given to the industry that its case would be considered afresh when domestic supply of soda ash would improve.

Towards the end of the 1930s imports of glass-ware had begun to decline and a few factories began to work profitably. Further stimulus to the development of the industry was provided by the Second World War. When the war ended and foreign competition threatened to submerge the industry, it applied again for protection. This was given in 1948 by converting the existing 45 per cent revenue duty into a protective duty for five years.

The industry suffers from a shortage of good quality raw materials, fuel and skilled labour. The small scale and poor organisation of many of the units also stand in the way of development. As glass is a very important material, attempts are being constantly made to improve glass technology in India to catch up with foreign standards of achievement. The Government of India set up the Central Glass and Ceramic Research Institute in Calcutta in 1950 with this objective in view.

In 1945 India had 96 glass factories with an aggregate out-turn of 1.5 lakh tons of glass. Domestic production met only a very small fraction of Indian demand and imports worth about Rs. 3 crores per year were recorded in 1947–48.

The Cement Industry

As an important building material cement is greatly in demand in all societies aiming at economic development. In India the production of Portland cement first started in a factory near Madras in 1904. But this factory ceased production after a short time. In 1912–13 three new cement factories came into existence in Porbandar (Gujarat), Katni (Madhya Pradesh) and Bundi (Rajasthan) but together they produced less than 1,000 tons. In the First World War bulk purchases of cement on Government account stimulated the industry's growth and by 1924 production had reached 2.4 lakh tons. The industry continued to expand even during the years of the Great Depression and on the eve of the Second World War Indian production of cement was nearly 12 lakh tons. Imports of cement declined from about 1.7 lakh tons in 1913–14 to only 21 thousand tons in 1938–39.

The organisation of the industry improved with the amalgamation, in 1936, of ten principal producers into the Associated Cement Companies of India Limited. This enabled the industry to improve both techniques and marketing arrangements. A number of other cement companies were controlled by the Dalmia group which remained outside the above-mentioned combine.

The industry's claim for protection was turned down in 1924 on the ground that the industry was already suffering from excessive internal competition. The tariff board investigating conditions in this industry, however, recommended the grant of bounties to cement produced in factories which were at a disadvantage in respect of location. One of the problems usually facing the outlying units in the cement industry has been the high cost of coal and the scheme of bounties was designed to offset this disadvantage. No action was taken at the time to help the units in difficulty.

During the Second World War domestic demand for cement, particularly for construction of buildings, declined owing to the fact that steel, a complementary material, was in extremely short supply. Exports of cement were arranged and production was maintained at a high level. The end of the War saw an expansion in building and constructional activities which raised the domestic demand for cement very sharply. On the eve of Independence production of cement in India exceeded 20 lakh tons in a year.

The Matches Industry

A factory for the manufacture of safety matches was set up in Ahmedabad in 1895. But no other factory is known to have come into existence before World War I. The scarcity of imported matches during the war as well as the high revenue duty on such imports in the post-war period led Indian enterprise to move into this industry. But the industry came to be dominated by a Swedish combine which started manufacturing in India behind the wall provided by the revenue tariff.

The matches industry was granted protection in 1928 although the tariff board enquiring into the application for tariff expressed the opinion that the industry was quite capable of facing foreign competition without the assistance of protection. To encourage enterprise, however, the existing revenue duty was converted into a protective duty and this was followed by further expansion in the industry so that the country became almost self-sufficient in this commodity before the Second World War.

The industry consists of a large number of small firms on the one hand and a very limited number of large firms, including the gigantic Swedish combine, on the other. The problem is to ensure that the latter do not force out the former by price-cutting and other devices. The industry has also been facing problems of adequate supply of splinter wood and other ingredients.

An excise duty on matches was first imposed in 1934 and the rate of duty was enhanced by stages during the Second World War. At the close of the war India was producing over 20 million gross boxes of matches per year.

The Chemicals Industry

Before the First World War there was hardly any production of chemicals in India. The requirements for chemicals in the cotton textiles and

paper industries were met by imports. The cessation of imports during that war brought into existence a number of chemical-producing plants in India, but these were not very efficiently planned. When foreign competition revived after the war, many of these plants proved to be unremunerative. It was, however, essential to encourage the growth of heavy chemicals production in the country, since such chemicals constituted the basis for the manufacture of finer chemicals and drugs. An application for protection to the heavy chemicals industry was submitted in 1928 in which the argument was put forth that, being a key industry, heavy chemicals deserved specially generous treatment from the fiscal authorities. The Government of India showed little awareness of the special role of the heavy chemicals industry and arranged for some degree of protection in 1931 only after protracted enquiries. The result of protection was, however, beneficial. The number of factories producing chemicals increased substantially between 1931 and 1939. But the factories turned out only a narrow range of products and the amount produced was too small to meet domestic requirements in full. In fact, between 1914 and 1939 imports of chemicals into India increased by over 300 per cent.

The Second World War once again created a situation favourable for the expansion of the chemicals industry. Domestic production increased to meet the scarcity caused by the cessation of imports. A beginning was made in the production of several items of chemicals for which India had so long been relying solely on imports. After the war many of these new chemicals-manufacturing units received protection under the liberalised tariff policy adopted in 1945. The post-Independence period saw further diversification in the production of chemicals in the country. In a number of instances foreign technical collaboration was sought to start the production of new varieties of chemicals whose importance was rapidly growing with the greater industrialisation of the country.

The industry remained weak, because most of its units were too small for economical working and suffered from lack of facilities for purchase of raw materials and fuel. One of the handicaps of chemicals production in India is that coal, from which many important chemicals and dyes are derived, is very unevenly distributed in India.

The Engineering Industry

Modern engineering methods were introduced into India in connection with the construction of roads, bridges and railways in the nineteenth century. The railway repairing shops were probably the earliest units of the engineering industry in India. In the early years of this century a number of steel-fabricating plants came to be established in the vicinity of the iron and steel plants, specially in and around Jamshedpur.

In the early years the development of the engineering industry was hampered by the Government of India's policy of importing the bulk of

engineering stores from England. Even when the Stores Purchase Rules were relaxed in 1909 the engineering units continued to complain about the inadequacy of orders from the government.[5] Most of these engineering units were, however, owned and looked after by the Britishers.

The First World War brought about a reduction in engineering imports. But since the Government of India's capital expenditure was considerably reduced during the war years, the domestic engineering units had little scope for expansion. The difficulty of obtaining essential materials and equipment from abroad also prevented the industry from taking up new products for fabrication.

The Government of India did not appear to be at all anxious to reduce the country's dependence on foreign imports for machinery and transport equipments. A Tariff Board finding in 1924 that the railway locomotive industry was deserving of protection was brushed aside by the authorities. Several years later, an important step was, however, taken to provide some support to the Indian engineering firms; the Stores Purchase Rules were revised in 1928 to provide for rupee tenders in purchasing engineering and other stores for government use. This afforded a greater opportunity to Indian engineering firms to compete with their British and European counterparts, but did nothing to offset the cost advantages of the latter. Besides, in this industry, the domestic units had to suffer also from a largely irrational preference in favour of imported products against which special safeguarding measures should have been taken by the authorities.

The Second World War created conditions favourable for the development of new types of engineering works; consumer goods like bicycles and capital goods like machine tools came to be produced on any significant scale only during this war. Most of the new engineering industries that were born in this period were protected after the war. Special measures to expand capacity in these industries and to introduce new engineering goods for local manufacture, often with foreign technical collaboration, could be initiated only after a national government took over the reins of power in 1947.

The Coal Mining Industry

The Industrial Revolution that shook the Western World in the late eighteenth and nineteenth centuries was based on coal as the main source of power. Even after electric power came into general use, the importance of coal has remained virtually unchanged, since a very large proportion of electricity generated comes from coal-based power-generating units. Coal mining in India started in the Ranigunj coal-fields of Bengal in 1820. But until the railways were opened, the demand for coal in the country was very limited. The railways not only opened up new uses for this mineral, but also facilitated its use in mechanised plants all over the country by arranging for

5. See Sen, S.K., *op. cit.*, pp. 46–47.

its transport. In India the coal-fields are not well-distributed and the use of coal as fuel depends very largely on the ability of the railways to carry coal from the pit-heads to the consuming centres. As the railway network developed, the demand for coal rose in all parts of the country. According to Mr. G.A. Stonier the output of coal in the Bengal coal-fields rose from about 3 lakh tons in 1857 to over 10 lakh tons in 1880.[6] By 1914 production (including output from other coal-fields) rose to nearly 165 lakh tons. By 1950 India was producing about 320 lakh tons of coal.

Initially the capital and enterprise for opening up the coal-fields came from Europeans but towards the end of the nineteenth century Indian entrepreneurs also began to enter this industry. In the early years of this century Indian coal producers had to compete with South African coal, the cost of transport from Durban to Bombay by sea being smaller than the cost of railway transport from Eastern India to Bombay. The cost of raising coal was also relatively high in India because of the virtual absence of mechanisation in the coal mines and the poor efficiency and excessive absenteeism of the mining labourers. In 1926 the coal industry applied for protection, but this application was rejected by the Tariff Board which conducted the enquiry into the conditions of this industry. Some steps, however, were taken to improve the productivity of the industry by building up a more stable and efficient labour force and by taking steps for raising the output of superior coal. Although India's stocks of coal are quite high (estimated as 20,000 million tons down to a depth of 1,000 ft.), most of the coal raised is of low quality and is unsuitable for use in metallurgical industries. The known reserves of first-grade coking coal, suitable for metallurgical purposes, may not be much higher than 700–750 million tons.

From the technical angle the coal industry's problems have been extensively investigated by the Indian Coal Committee (1924), the Coal Mining Committee (1936) and the Indian Coalfields Committee (1946). The last-mentioned Committee, in particular, enquired into the problems created by the division of the coal-fields into fragmented units under the then existing pattern of ownership and investigated in this context the possibility of nationalizing this 'key' industry. While a number of collieries were already under State ownership by 1950, having been acquired from the railway companies, the government had not yet been able to establish any claim for superior management which could justify wholesale nationalisation. At the time of Independence in 1947, an integrated policy of development and modernisation of this crucially important industry still remained to be evolved.

6. See Sen, S.K., *op. cit.*, p. 33.

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Industrial Organisation and Finance before Independence

The organisation of Indian trade and industry had from time immemorial been based on the rules of caste and joint family. Trading and industrial units would in most cases be family-based partnerships, maintaining certain loose links with similar units within the same caste. The rules of caste would determine the choice of occupation, while the rules of the family decided the framework of the organisation of a business concern. Members of a caste were engaged in limited competition with one another, but stood as guarantors for fellow-members in need of credit and as helpers in cases of distress and special disabilities. In return, the leaders of the caste claimed the right of overseeing the level of performance of members in the same caste and of laying down rules relating to modes of marketing, customary charges and fees, and other rules of business.

By tradition not all castes were permitted to engage in commerce and industry. The sacerdotal caste (*Brahmanas*), the fighter caste (*Kshatriyas*), the husbandmen, the quill-drivers (*Kayasthas*) and a number of other castes had other occupations assigned to them. The commercial and industrial class was included in the third broad group (*vaisya*) of the four-fold caste division of the Hindus, but not all *vaisyas* were permitted to take up commerce or manufactures. Further subdivisions in the caste system made occupational choice very inflexible indeed. Nevertheless, the permitted sub-castes usually found the caste rules of great benefit to themselves since such rules eliminated unrestricted competition and upheld a certain tradition of mutual aid.

The commercial groups successfully operating in the eighteenth century were generally caste-governed Hindu family partnerships. Muslims, while they did not abide by the rules of caste, largely spurned commercial occupations and preferred landlordism and military services. The advent of British rule appears to have allowed a number of relatively minor non-Hindu groups to penetrate the monopoly in commerce enjoyed by the caste-conscious Hindus. Communities such as the Parsis, the Jains, the Jews, Armenians and Bohras, who had never been prominent in the commercial arena before, began to associate themselves with the British commercial houses and in course of time set up their own commercial ventures. Although among these communities caste rules were not observed, they also

usually fashioned their business houses according to the model set up by the commercially successful Hindu joint family. Individual ventures or partnerships formed with members outside the family fold were few and farbetween.

The nineteenth century, however, saw quite a few partnerships between Indian and British merchants. In fact, the idea of picking commercial partners from outside the family fold was derived from the widely prevalent partnership system among the European merchants then working in India. The European Agency Houses which came into existence in the last three decades of the eighteenth century were mostly partnerships of two or more business *confreres*. The partnership form enabled capital and managerial functions to be shared on an equitable basis and enabled some partners to attend to the Indian business while allowing others to look after the partnership's interests outside India (*e.g.*, China and elsewhere).

The joint-stock company with limited liability of shareholders became possible after 1857; it may be noted that the limited liability principle had been introduced in England only a year before. But a number of companies had been incorporated in the 1840s under special Charters and Acts. One of the most remarkable ventures of this type was the Assam Company formed in 1845 "for the purpose of prosecuting and extending the culture and manufacture of tea" in Assam and the North-Eastern parts of India. The Assam Company had an authorized capital of Rs. 50 lakhs divided into 10,000 shares of Rs. 500 each. Its shareholders included both Indians and Europeans.[1] The shareholders' liability in these specially incorporated companies was, of course, unlimited.

British companies incorporated under Royal Charters or Acts of the British Parliament also came to operate in India in the period after 1833 when restrictions on the activities of private British capitalists in India had been lifted under the terms of the East India Company's new Charter. The most well-known of these companies were the railway companies which were formed in the 1840s to carry out the task of opening the country to rail transport. The companies formed in Britain siphoned British capital into India which had, by 1830, been seeking outlets for investment abroad. Although no firm estimates of the investment of British capital in Indian industries, including transport and power industries, are available, the amount may have reached a figure of between £250 and £350 million by the beginning of the twentieth century.

As a legal entity the joint-stock company came to be recognised in India for the first time in 1850 when the country's earliest Companies Act was

1. Some of the names of the Assam Company's Indian shareholders will indicate that the Bengali zamindars were not as aloof from commercial ventures as has often been held as a charge against them. The families of Tagores, Laws, Seals and other members of the landed aristocracy of Bengal subscribed to this Company's shares. See Sen, S.K., *Studies in Industrial Policy and Development of India*, Ch. VII.

passed. This Act authorised any seven or more shareholders to register themselves as a company. Registration as a company created the legal 'fiction' that the company had a separate existence apart from its shareholders. It also permitted the shareholders to transfer their shares to anyone without securing the approval of the rest of the shareholders. The company form of organisation, however, did not prove immediately popular, since the shareholders' liability remained unlimited, until the limited liability principle was given recognition through another Act in 1857. The New Oriental Life Insurance Company is believed to have been the first company to be registered under the Act of 1850. Up to 1860 only 60 companies had registered themselves under the Companies Act. Afterwards there was a sudden spurt in company formation, not only because limited liability had been accepted, but more importantly because the early 1860s witnessed a business boom owing to the favourable economic climate created by the Civil War in the U.S.A. By 1865 the number of registered companies rose to 373. When the nineteenth century closed, the joint stock company had become quite firmly established in India. "During the nineteen years (1882–1901) 2,692 companies were registered as compared with only 1,149 in the preceding thirty-five years." Although many of the early ventures failed, there were in existence, in March 1901, 1,366 companies throughout India (including Burma) with a paid-up capital of Rs. 37.06 crores. At about this time British capital in the major industries of India (tea, jute and coal) probably amounted to about Rs. 22 crores.[2]

The Managing Agency System

A peculiar business entity, known as the Managing Agency firm, has existed in India from the early years of the nineteenth century as an adjunct of the company form of organisation. While the company has usually consisted of several (after 1850, more than seven) shareholders, the Managing Agency firm has usually consisted of a relatively few partners. These latter have stood in relation to the former as managers or agents to discharge the functions for which the company was floated. An early example of such an agency firm, managing for a remuneration a concern floated by a different group of people, has recently come to light from the annals of an insurance firm established in Calcutta in 1809.[3] Later in the century this practice of appointing managing agents came to be adopted by a large number of companies, both British and Indian.

The reasons why the managing agency type of arrangement won such ready acceptance among businessmen in India are worth analysing. In the early nineteenth century, business enterprise, particularly of a pioneering

2. Rungta, R.S., *Rise of Business Corporations in India*, 1851–1900, p. 265.
3. Rungta, R.S., *op. cit.*, p. 223.

nature, was in extremely short supply in India. Capital seeking business outlets was, however, not so scarce. The accumulated savings of the British officials, the private European merchants and the Indian commercial classes was not inconsiderable. Not all the people who were eager to invest their capital in new commercial and industrial ventures were equipped to assume responsibility for working on the enterprise. The managing agency system offered a solution by permitting a division of functions between the owners of a business concern and its managers. The managing agency firm offered its services for the management of concerns owned by others in consideration of a remuneration. The basis and amount of this remuneration varied from one managing agency agreement to another. But it was usually substantial enough to induce astute businessmen to group themselves into managing agencies to look after funds invested by other capitalists, even when they themselves had little to contribute by way of capital. The managing agency thus brought about a proper marriage between pure business acumen on the one hand and capital funds on the other in cases where each badly needed the other.

In the case of companies incorporated in England there was an additional reason for welcoming the managing agency arrangement. The shareholders of such companies would be hard put to it to find out a group of Directors who would migrate to India to assume responsibility for the day-to-day administration of the companies. A managing agency firm, resident in India, could relieve the shareholders of this worry and could even suggest new lines of expansion of their Indian business to the companies in Britain. In fact, even the limited dynamism which British investors showed in respect of their Indian investments would hardly have been possible without this peculiar institutional arrangement. As the system evolved, the same managing agency firm became entrusted with the management of a number of companies domiciled abroad. In some ways this secured economy of administration; a number of companies, often unrelated to one another, could utilise the same general office, the same stock of liquid capital and the same specialists maintained by the managing agency firm. But it was not unlikely that an over-burdened managing agent might also cause considerable harm to the companies under his charge.

By the second half of the nineteenth century the managing agency firms had become not merely repositories of industrial and commercial expertise, but also the owners of a substantial capital fund. A large part of business 'goodwill' also inhered in the managing agents and a company's financial standing came to depend very largely on the reputation of the managing agent who managed it. The commercial banks of the country began to insist on the managing agent's signature before lending to a company even against its fixed assets. In this phase of the development of the managing agency system, therefore, many companies found it necessary to turn to managing agents for financial reasons alone. Unless a new company could

secure the patronage of an established managing agent, its shares would be difficult to sell and liquid finance would be hard to procure. Occasionally the managing agents would invest some of their own funds in the shares of companies which they wanted to take under their protective wings, subsequently disposing of their shares to the public. Managing agency funds thus served as a sort of 'revolving' fund for ushering in new companies at a time when the capital market in the country was undeveloped and a direct appeal for public subscription to company shares would in all probability have gone unheeded.

Although the managing agency system was thus found serviceable, it contained within itself potentialities for abuse which ultimately brought the system into disrepute. The interests of the managing agents were not in most cases identical with those of the owners of the companies which they managed. Several examples can be given of such conflicts of interest. The managing agents' remuneration was often based on the gross output of a business and it would be to the agents' interest in such cases to plan for a larger output than could be profitably sold. Sometimes the managing agents would earn a commission on purchases and it would be very natural for them to inflate the value of such purchases even though this raised the cost of production and injured profits. A managing agent could borrow at relatively cheap rates from the surplus funds of a profitable concern under his management and re-lend such funds at higher rates to needy concerns. Many unscrupulous managing agents utilised information which they collected in course of their work to speculate in the shares of the companies managed by them, thereby inflicting losses on the shareholders of these companies. These and other abuses, though well recognised, could not be dealt with through legislation until 1936 because (*a*) the Indian Companies Act was too closely built up on the British system and ignored Indian realities and (*b*) attempts at reform occasionally undertaken, for example in 1914, were vehemently resisted by both British and Indian commercial interests. As the years passed, many Indian managing agencies even lost their earlier competence; as such agencies tended to become hereditary incompetent successors took the place of the more able pioneers.

The Amendment to the Indian Companies Act in 1936 limited the term of a managing agent to twenty years at a time and provided for his removal by the shareholders even before this period on charges of fraud or breach of trust. The managing agent's control over the company was sought to be reduced by providing that not more than one-third of the total number of directors of the company could be nominated by the managing agent. The remuneration of a managing agent was to be based solely on the net profits of concerns under his management; no other basis like gross output or gross sales would be legally valid. The managing agent's right to borrow from the funds of a managed concern was regulated and commission rights on the sales or purchases of the company were also

sought to be restricted. The provisions, however, were not without loopholes and the managing agents succeeded in evading the terms of the Act in many cases to the detriment of the interest of the shareholders of the managed companies.

During the Second World War rising profits in many industries enabled a number of managing agents to dispose of their managing agency rights at fabulous prices without any concern for the interests of the shareholders. This trafficking in managing agency rights brought into the forefront once again the issue of curbing the powers and privileges of managing agents by putting them fairly and squarely under the control of the shareholders and an elected Board of Directors. In October 1950 the Government of India set up a Company Law Committee to go into this issue along with other aspects of reform of the Companies Act. As in the past, this revision of the Indian Company Law was undertaken in the wake of the new British legislation on companies following extensive investigations on this subject in that country by the Cohen Committee during 1946–47.

The Companies Act of 1956 introduced several new restrictions in the matter of company promotion and management. The appointment or re-appointment of a managing agent had to be approved by a general meeting of the shareholders of the company to be managed, and was further subject to the approval of the Central government. No managing agent was to be appointed for more than 15 years (20 years in case of re-appointment). No managing agency right was to be transferred without the approval of the company's shareholders and the government. The remuneration of a managing agent was ordinarily limited to 10 per cent of the profits of the company managed by the agent. Managing agents were restrained in regard to borrowing from the company's funds and making inter-company transfers of funds. The managing agent was to act under the direction and control of the elected Board of Directors of the managed company. Not more than 2 Directors (where the number of Directors does not exceed five, only 1 Director) could be appointed by the Managing Agent. Certain restrictions were also imposed on the number of company directorships a person might accept and on the number of companies to be looked after by a managing agent.

The Act envisaged the ultimate abolition of the system of managing agency. Companies were to be looked after in future by groups designated as Secretaries and Treasurers and receiving remuneration at not more than 7½ per cent of the net profits of the Companies under their stewardship, on by individual managers remunerated at not more than 5 per cent of net profit. The Central government armed itself with the power to notify that certain types of business would no longer be allowed to be managed by managing agents. All existing managing agency agreements were to be terminated by August 15, 1960 and fresh agreements were to be drawn up according to the provisions of the Companies Act.

As on March 31, 1981 there were 63,655 joint stock companies at work in India of which 62,001 operated with liability limited by shares. The paid-up capital of this latter group was Rs. 14,675.5 crores. Again, the number of public limited companies was 9,101 (paid-up capital Rs. 3952.1 crores) while private limited companies numbered 52,900 (paid up capital Rs. 10724.4 crores). Between 1951 and 1981 the number of public limited companies declined from 12,568 (paid-up capital Rs. 566.5 crores) to 9,101; on the other hand, private limited companies increased from 15,964 (paid-up capital Rs. 208.9 crores) to 52,900 during the period. Maharashtra had the largest number of limited companies, followed by West Bengal, but in respect of new company registrations, eight States were ahead of West Bengal in 1981, Maharashtra being again in the lead.

Among the limited liability companies working in India in 1981 there were 851 government companies (that is, companies in which government held at least 51 per cent of share capital) with Rs. 10,853 crores as their paid-up capital. More than half of these companies were private limited companies. In the early 1960s (in 1962) there were only 154 government companies in the country, their paid-up capital being about Rs. 630 crores. The number of government companies in 1951 was much less: only 51 such companies were at work with a paid-up capital of Rs. 26.3 crores.

Joint stock companies incorporated abroad, but having a place of business in India, were declining in number. Out of 300 such companies at work in 1981, 133 had their head office in the United Kingdom and 57 in the United States, followed by Japan (with 19 companies) and other countries.

Indigenous and Foreign Capital

With the advent of British rule the wealthy nobility of Muslim India were deprived of some of their wealth, but the commercial classes on the whole were allowed full scope to carry on their activities subject to the overall commercial supremacy of the ruling powers. In the early years after the East India Company's rule was established there was some economic chaos following the political upheavals. But with the return of more settled conditions in the 1770s indigenous traders and financiers found it possible to offer their services to the Britishers in various capacities and thus to make a gainful living. At least until the middle of the nineteenth century there was no general feeling of a scarcity of capital in India; as distinct from a scarcity of specie. Business of almost any sort found financial supporters among the native merchants and landlords. It was only with the introduction of more capital-using, mechanised, methods of production that capital began to appear as scarce.

It has often been said that capital in India is not so much scarce as 'shy'. The boom that opened with the cotton speculation in Bombay in the 1860s

gave clear evidence of the Indian's flair both for involvement in speculative orgies and for abject passivity in the face of confidence tricks perpetrated by suave speculators. In fact, this boom and the subsequent bust must bear a good deal of responsibility for the 'shyness' of capital in India in the succeeding years.[4] An unsympathetic government and an alien banking system remained completely indifferent to creating a favourable climate for the growth of business confidence without which a long-term capital market could hardly develop.

Even then, as we have seen, by the beginning of the present century the amount of indigenous capital in registered jointstock companies had reached a figure of Rs. 37 crores. The boom created by the First World War brought about a spurt in investment and in 1920 the paid-up capital of joint-stock companies stood at Rs. 123 crores. In 1929–30 Dr. Jeidels, a foreign expert associated with the Indian Central Banking Enquiry Committee, estimated the total *indigenous* capital invested in India at Rs. 700 crores, this figure including not merely industrial and company investment but also bank deposits and investments in government and other securities.[5]

In 1950 the Planning Commission estimated the value of productive capital employed in the private sector as Rs. 1,472 crores; the share of foreign capital in this total will certainly be less than 20 per cent (see *infra*, p. 137). At the same time the productive capital assets in the public sector, financed largely by indigenous sources, amounted to over Rs. 2,200 crores.

The amount of foreign capital invested in India has been variously estimated. Edgar Crammond's estimate for 1896 was £294 million, while George Paish estimated that in 1909–10 British investments in India exceeded £365 million.[6] The bulk of this foreign capital was invested either in government bonds or in the shares and bonds of railway companies. Tea, coffee and rubber plantations had also attracted a certain amount of foreign capital. Minerals like coal and petroleum had begun to be explored with the participation of foreigners. Foreign banks operating in India had brought in a certain amount of foreign capital for making investments in India. A certain amount of foreign capital had also come to be invested in such public utilities as electricity generation, tramways and waterworks, but

4. See Wacha, D.E., *A Financial Chapter in the History of Bombay* (1900). The commercial climate in Calcutta was equally perverse. See Singh, S.B., *European Agency Houses in Bengal*, p. 304.

5. Indian Central Banking Enquiry Committee Report, as cited in Lokanathan, P.S., *Industrial Organisation in India*, p. 139.

6. Both Crammond and Paish included investments in Ceylon in their estimates for total British investments in this region and, of course, the territories of present day Burma and Pakistan were also covered by their estimates. Crammond's estimate was originally published in the *Quarterly Review*, 1907. Paish presented his estimate in the *Journal of Royal Statistical Society*, 1909 and 1911.

according to Paish's estimate such 'infrastructure' investment constituted less than 1 per cent of the total foreign investment.

The methods used by Crammond and Paish in building up their estimates left much to be desired. Both of them used published British data relating to foreign securities issued in the British capital markets. Hence they had to leave out of their estimate securities privately placed or investments financed out of rupee funds accumulated by foreigners or foreign-owned firms in India. When these have been taken into account, total British investment in the Indian economy prior to the First World War may well have exceeded £400 million (Rs. 600 crores). In fact H.F. Howard in 1911 put the figure for total British investments in India alone as £450 million. His estimate, unlike the estimates of Crammond and Paish, included the rupee investments of foreigners.[7]

At the close of the First World War statistics relating to companies at work in India showed that there were 634 companies incorporated outside India, with a paid-up capital of £420.63 million along with debentures amounting to £102.73 million.[8] As more and more foreign companies began to be incorporated with rupee capital under the Indian Companies Act in the inter-war period, the difficulties of discerning the movement of foreign capital from company statistics became insoluble. No official statistics relating to inflow of foreign capital was available either. A stray estimate by the Midland Bank for 1922–23 revealed that India imported about £38 million of foreign capital funds in that year.[9] During the same period India's annual liability for interest and dividend payments abroad amounted to over £17.5 million.

During the period of the Great Depression when India was passing through a balance of payments crisis the problem of servicing foreign investments naturally loomed large and efforts were made afresh to measure the extent of the foreign debt burden. G. Findlay Shirras put the amount of foreign investment in 1929 at £500 million, but this was almost immediately challenged by others who pointed out that Shirras had entirely neglected the rupee company holdings of foreigners as well as rupee securities owned by them. G.D. Birla suggested that the amount of foreign investment in 1929 could be as high as £1,000 million if foreigners' holdings of all kinds of rupee securities and the value of investments in unincorporated business were taken into account. But there was little statistical support for his assertion. V.K.R.V. Rao produced a compromise figure of £637.5 million, but his methods also were not fully convincing.[10] In short, no

7. Howard, H.F., *India and the Gold Standard*, 1911, Ch. V, as cited in Pillai, P.P., *Economic Conditions in India*, p. 281.

8. Pillai, P.P., *op cit.*, p. 283.

9. Pillai, P.P., *op. cit.*, p. 282 fn.

10. Estimates by Shirras, Birla and Rao were published in the Economic Journal during 1932–33.

firm and comprehensive estimate of foreign capital holdings in the Indian economy existed at the time. B.R. Shenoy's estimate of £829.8 million for 1939[11] was based on assumptions similar to Rao's and contained a number of equally doubtful items.

It was only after Independence that the Reserve Bank of India decided to undertake a survey of India's liabilities (as well as assets) abroad through the questionnaire method. By this time, of course, a considerable part of the foreign capital earlier invested in this country had been repatriated. Sterling assets accruing to the Government of India during the Second World War were utilised to pay off the holders of sterling securities in Britain, while war-time profits enabled Indian capitalists to buy up foreigners' holdings in Indian enterprises. This explains why the Reserve Banks' survey returned a figure of less than £400 million as India's gross foreign liability in 1948. Of this amount about £200 million (Rs. 255.83 crores) could be regarded as 'productive' investment, as distinguished from investments in government, other public and semi-public institutions, and banks.[12]

The Reserve Bank survey also revealed that of Rs. 255.83 crores worth of non-banking foreign private-sector investments in India, over 28 per cent went into manufacturing, 25 per cent into trading, 20 per cent into plantations, 10 per cent into public utilities and transport, about 4.5 per cent into mining and the rest was employed in other miscellaneous activities. Among industrial investments jute and tea accounted for Rs. 15.7 crores and Rs. 51.6 crores respectively. Coal had about Rs. 5 crores of foreign capital invested in it while the iron and steel group accounted for Rs. 6.5 crores. Banking capital accounted for about Rs. 40 crores, while foreign capital in the official sector of the economy was estimated at Rs. 178 crores.

The Reserve Bank survey also brought out the important fact that nearly 80 per cent of the foreign capital in the private sector of the economy took the form of direct business investment, the amount of 'portfolio' investment in 1948 being only Rs. 67.80 crores. This implied that foreign capital had mostly entered India in combination with foreign organisation and enterprise, not simply as financial investment in firms controlled by Indian entrepreneurs. It was this dominance of foreign, mostly British, enterprise in the Indian industrial field that gave rise to feelings of apprehension and insecurity among Indian businessmen and the public.[13] In the period before Independence, foreign industrialists entrenched in India, specially in lucrative industries like jute and tea, did everything in their power to block the entry of Indian competitors in what they regarded as their close preserve. Charges were also frequently made that British-owned banks and railway companies discriminated against Indian traders and industrialists in matters

11. Shenoy, B.R., *The Sterling Assets of the Reserve Bank of India* (1943).

12. See *Reserve Bank of India Bulletin*, June 1959.

13. British investments constituted over 80 per cent of direct business investments in 1948. The U.S.A. was a poor second with less than 5 per cent.

like credit and railway facilities. The foreign companies also generally followed a policy of recruiting superior staff from abroad and did not offer adequate training facilities to Indians. They were also vehemently opposed to all schemes of transferring political responsibility to Indians. Even when the British Government would agree to introduce the institutions of responsible government in India, these foreign companies would clamour for economic 'safeguards' and get these recognized in the constitutional documents either openly or on the sly.

The period after the First World War saw the Indian business community protest with renewed self-confidence against the encroachment of the foreigner; the boom had made the community both more assertive and less appreciative of the value of foreign capital to the economy. In the exploration of minerals in particular the foreigners followed a policy of wasteful depletion. Valuable minerals were extracted without any thought of conservation and exported without being processed and utilised for creating employment at home. These and other problems created by the unrestricted operation of foreign capitalists in India led in 1924 to a study of the relevant issues by the External Capital Committee set up by the Government of India. The majority report of this Committee admitted the necessity of imposing certain regulations on foreign capital entering India. In the first place, foreign capital should not shut out Indians from participation and in order to make this possible foreign capitalists should be required to form their companies with rupee capital and get these incorporated in India under Indian laws. Moreover, a proportion of such capital should be kept reserved for Indian subscribers who should have the right to have proportional representation in the company's Board of Directors. Secondly, all foreign companies should be required to provide facilities for the training of Indians and offer a certain proportion of senior positions to such trained persons. At the same time, it was recognised that putting too many restrictions on the operations of foreign capitalists could easily reduce their inclination to invest in India, particularly in the immediate post-war period when all countries needed large amounts of capital for the rehabilitation of their war-damaged economies.

Indian attitude to foreign capital changed perceptibly after Independence. It was, of course, always admitted that foreign capital had done a good deal of the pioneering work in establishing modern industries in India and also that, in the existing state of the Indian capital market, relying solely on indigenous capital would have made the pace of economic development even slower than what it actually had been. But the fear of economic and political domination very naturally clinched the issue so long as effective political power did not rest with Indians. After Independence the Indian Parliament was confident and forward-looking enough to accept without demur the following statement from Prime Minister

Nehru:[14] "Government will not object to foreign capital having control of a concern for a limited period, if it is found to be in the national interest,... and ...to the employment of non-Indians in posts requiring technical skill and experience, when Indians of requisite qualification are not available." In general, however, the government was to insist on a policy of retaining the major interest in ownership and the effective control in Indian hands and of training up Indian experts to replace foreign personnel in due course. Encouragement to foreign capital was regarded as conducive to economic development, provided that such capital was obtainable on ordinary commercial terms without 'strings' attached. Such encouragement was provided in the Prime Minister's statement by assuring foreign investors that (*a*) no discrimination would be made between foreign and Indian investors in the application of industrial regulation measures, (*b*) no restrictions would be put on the repatriation of capital and the remittance of profits, subject to the availability of foreign exchange, and (*c*) in the event of nationalization, foreign investors would be entitled to fair and reasonable compensation. After 1950 the inflow of 'aid' capital, received on somewhat concessional terms, has largely transformed the problem of foreign capital as it was known to India in an earlier period.

14. Statement on foreign capital and investment made by the Prime Minister on 6th April, 1949.

13

Industrial Development and Policy since Independence

At the time of Independence in 1947 the number of workers in registered factories in India was only about 22 lakhs or less than 1.5 per cent of the working population. But there were much larger numbers engaged in traditional industrial occupations or in small industrial workshops that did not qualify as factories. No reliable estimate exists regarding the total value of industrial production in the country at this time. One unofficial estimate in 1945 put the industrial output at about one-fifth of the gross domestic product. However, according to the National Income Committee, which was set up by the Government of India shortly after Independence, the share of the 'mining, manufacturing and small enterprises' sector in 1948–49 was slightly above 17 per cent (Rs. 1480 crores out of Rs. 8670 crores at current prices) of the net national product.

Apart from its very small size, the modern industrial sector was largely confined to a few simple consumer goods like cotton textiles or sugar. There was only a token production of commodities like steel or basic chemicals which provide the foundations on which an industrial structure is built, as the experience of the industrially developed countries will show. Most of the requirements of machinery for cotton or sugar mills had to be met from imports, since machine-building industries were hardly in existence.

By the end of the Fifth Five Year Plan, in 1978–79, the number of employees in registered factories rose above 70 lakhs. But even this higher figure accounted for no more than 3 per cent of the country's estimated working population. Many new types of industrial establishments came into existence during the years since Independence, partly because of greater venturesomeness shown by private enterprise, but more often because of the greater involvement of the government with industrial growth. The establishment of several large industrial undertakings in the public sector has been a major feature of the country's economic development in the post-Independence period. The total investment of the Central government in public sector industrial undertakings was officially stated as Rs. 12,800 crores as on March 31, 1979. The more important public sector undertakings have been working in the fields of steel production, non-ferrous metals such as zinc, copper and aluminium, petroleum production and

refining, chemical fertilizers, drugs and pharmaceuticals, heavy engineering and the generation of electric power.

Industrial Policy Statements

After Independence the Government of India announced in its first Industrial Policy Resolution (April 6, 1948) that, from the point of view of future development, industries in India would be divided into the following categories:

(*a*) industries in which the State was to have exclusive monopoly, such as arms and ammunition, atomic energy generation and the railways.

(*b*) industries for which the State will be exclusively responsible, so far as establishment of new industrial undertakings are concerned, but existing private units will be allowed to continue for at least 10 years after which the issue of nationalisation of such units would be re-examined. Such industries included coal, iron and steel, aircraft manufacture, shipbuilding, manufacture of telegraph, telephone and wireless and wireless apparatus and mineral oils.

(*c*) industries which will be allowed to remain and expand under private enterprise, but will be subject to Central regulation and control because their location must be governed by factors of all-India import and also because they required considerable investment and a high degree of technical skill. A list of 18 such industries was drawn up of which the more important were machine tools, fertilizers, cotton and woollen textiles, cement, salt and paper.

(*d*) industries which will be left for further expansion to private enterprise, but progressive participation of the State in these fields as well was not ruled out, as the financial and managerial resources of the State improved.

The Industrial Policy Resolution of 1948 thus ushered in a 'Mixed Economy' in which the responsibility for future industrial development was to be shared between the State and private enterprise. The First Five Year Plan (1951–56) proposed a total investment of Rs. 327 crores for financing projects of industrial expansion; the public sector component in this total was to be only Rs. 94 crores. The Central and State governments were to invest Rs. 83 crores and Rs. 11 crores respectively on industrial projects. About Rs. 33 crores worth of industrial investment had already been made by the Central government before the First Plan started, mainly in the Sindhri fertilizer factory and the Chittaranjan locomotive factory for domestic manufacture of railway engines. In the First Plan the Central government proposed to invest mainly for expansion of iron and steel producing capacity and in the machine tools and shipbuilding industries. Some Central investment was also proposed for the establishments of a

factory at Perambur for railway coach building, a factory at Pimpri for the manufactures of Penicillin and several other industrial schemes. Industrial investment on State government account was to be made primarily in cement, newsprint and art silk industries as well for expansion of the capacity of the steel unit at Bhadravati (situated in the former Princely State of Mysore and already publicly owned).

The 'Mixed Economy' principle was modified to a considerable extent through the Second Industrial Policy statement presented to Parliament on April 30, 1956. The new policy statement proposed a classification of industries into 3 groups. In the first group (listed in Schedule A) 17 industries were proposed to be included, for the development of which the State was to be exclusively responsible. Apart from the three industrial groups for which exclusive responsibility was placed on the State in 1948, the other major industries included in this group were iron and steel, heavy machinery, heavy electricals, minerals and mineral oils, air transport, generation and distribution of electricity and shipbuilding. Thus categories (*a*) and (*b*) of the 1948 Policy Resolution were amalgamated and several new industries of national importance were included in this schedule. In the second group (Schedule B) were placed 12 industries which were to be progressively brought under State ownership and in which new units were generally to be set up as public undertakings. Private enterprise was to play only a supplementary and secondary role in the development of industries belonging to this group. Important industries in this group were ferro-alloys, chemicals and drugs, fertilizers, road transport and sea transport. Industries in the third group (Schedule C), such as cotton textiles, cement, sugar and so on, were to be "left to the initiative and enterprise of the private sector" but the State was to have the right to set up manufacturing units for industries belonging to this group as well.

The greater stress on public sector industrial enterprises, contained in the Industrial Policy Statement of 1956, was in keeping with the celebrated Avadi Resolution (1954) of the Indian National Congress Party which was continuously in power at the Centre from 1950 (when the first elections were held according to the new Constitution of the Indian Union) and 1977. The Congress Party did not adopt Socialism in its classical sense of 'public ownership of the means of production', as its goal and recognized certain elements of value in private enterprise, specially when such enterprise did not lead to industrial concentration. But it adopted a goal which was described as 'the Socialist pattern of Society', whose meaning, according to the Second Five Year Plan, was 'that the basic criterion for determining the lines of advance must not be private profit but social gain and that the pattern of development and the structure of socio-economic relations should be so planned that they result not only in appreciable increases in national income and employment but also in greater equality

of incomes and wealth.[1] New investment by the private sector was not ruled out, but it "has to play its part within the framework of the comprehensive plan accepted by the community". The State had to accept responsibility both for initiating developments which the private sector was unwilling or unable to undertake and also to shape "the entire pattern of investment in the economy, whether it (the State) makes the investments directly or whether these are made by the private sector"

The strategy of India's Second Five Year Plan was in favour of building up 'heavy' industries, with relatively mild stress on the expansion of capacity in light consumer goods. It was proposed that industrial investment excluding cottage and small-scale industries) during 1956–61 should be Rs. 1094 crores of which Rs. 915 crores would be for the expansion of capacity in machinery and other producer goods and Rs. 179 crores for consumer goods. Private enterprise was to assume responsibility for about 93 per cent of investment in the consumer goods sector, but for only 40 per cent in respect of producer goods. Among important schemes of industrial investment in the public sector were: three steel plants at Rourkela, Bhilai and Durgapur, a heavy engineering factory near Ranchi (Bihar) the lignite project in South Arcot (Madras), the Hindusthan shipyard at Visakhapatnam, a heavy electrical equipments plant at Bhopal and other relatively capital-absorbing development projects. The three steel plants alone were estimated to require an investment of Rs. 350 crores during 1956–61. The private sector was to be involved in the following schemes among others: expansion of capacity in the Tata Iron and Steel Works and Indian Iron and Steel Works (aggregate cost of investment estimated as Rs. 115 crores) expanded production in aluminium, ferro-alloys, cement and engineering industries, development of certain simpler types of machinery industries (e.g. cotton textile machinery) and modernisation of equipment in cotton mills and jute textile factories.

Industrial development strategy in the Third Plan (1960–66) was conceived more or less on the same lines as in the Second Plan. The emphasis on capital and producer goods was continued, with special emphasis on machine building. Among the important public sector industrial projects in the Third Plan were: establishment of a steel plant at Bokaro (Bihar), construction of a second shipyard in Cochin, construction of new fertilizer factories in several regions of the country, setting up the alloy and steel plant in Durgapur (West Bengal) and a number of small projects. The total public sector investment on all industrial expansion schemes was projected at Rs. 1261 crores for the Central government and Rs. 64 crores for the State governments (excluding programmes of mineral development). Industrial investment in the private sector was expected to be Rs. 1125 crores.

The Fourth Plan (1969–74) was drawn up at a time when the country was passing through a phase of industrial recession. In several important

1. Planning Commission, *Second Five Year Plan*, 1956–61, p. 22.

industries actual production dropped considerably below currently installed capacity. It was also realised that many of the new industries remained vitally dependent on imported equipments and spare parts, but they failed to contribute substantially to the country's foreign exchange earnings because of low production and low exports. The Fourth Plan, therefore, had to devote special attention to balancing the industrial structure and realising the full potential of the installed industrial capacity. In the Fourth Plan the Central government was to invest Rs. 2132 crores on schemes of industrial development, the State governments and Union territories were to invest Rs. 180 crores and the private sector was expected to invest Rs. 2400 crores on programmes of industrial expansion. The more important among the public sector industrial projects in the Fourth Plan were the following: expansion of steel producing capacity, expansion of fertilizer capacity, expansion of the heavy electrical plant and establishment of new pharmaceutical plants.

The index number of industrial production (1960 = 100) showed that at the end of the Fourth Plan as compared with 1951, the most remarkable gains had been made in the production of all types of machinery (most of which were not indigenously produced before Independence), metal products, drugs and chemicals, mineral oil derivatives, paper and paper products. Established industries like cotton textiles or jute, however, registered little or no progress. The general picture was one of fairly rapid expansion during 1951–66 followed by a slowing down of growth between 1966 and 1974 (the closing year of the Fourth Plan). While the general index of industrial production rose at an annual average rate of more than 7 per cent between 1951 and 1966, this rate was no more than 4 per cent during 1966–73. In respect of the machinery and equipment industries the rate of growth slumped by about 50 per cent. In transport equipments (specially railway wagons) the level of production at the end of the Fourth Plan was lower than in 1966. Recession also hit the manufacture of several other engineering products

The Fifth Five Year Plan (1974–79) sought to raise the rate of industrial growth to about 8 per cent per annum. Nearly Rs. 9600 crores were to be invested in this Plan on organised industry and mining as compared with Rs. 3050 crores in the Fourth Plan, but these figures do not take into account the rise in prices that had occurred in the intervening period. One of the features of industrial development policy in the Fifth Plan was the stress on liberalisation of industrial licensing, since rigid licensing was believed to be hampering the expansion of private enterprise by imposing too many restrictions on the setting up and expansion of industrial plants. A number of industries were exempted from seeking licences, some were permitted to produce beyond the licensed capacity and simplifications were introduced in the procedure for issue of industrial licences. These measures were adopted in several steps between 1973 and 1976.

Industrial growth was seriously handicapped after 1974 by the sharp rise in the prices of mineral oil and other petroleum products as well as by the considerable rise in the prices of some metals which India had to import from other countries. There were also domestic constraints in the form of inadequate generation of electrical power and irregular distribution of coal supplies. The annual average rate of growth of industrial production, as measured by the movement in the general index, was barely 5 per cent during the period 1974–78. Growth rates were very low in textiles, footwear, paper products and certain engineering industries.

In 1977 the prevailing industrial policy, pursued by the Congress Party for over two decades since 1956, was sought to be modified in certain respects by the coalition of several non-Congress parties that came to power at the Centre in the 1977 elections. A new Industrial Policy Statement presented to Parliament by the new (Janata) government in December 1977 stated that the "main thrust of the new industrial policy will be on effective promotion of cottage and small industries widely dispersed in rural areas and small towns". The earlier policy of the Congress Party was criticised for encouraging mostly the modern large-scale industries and thus allowing big industrial houses to dominate the industrial scene. In the new Industrial Policy Statement of 1977, it was stated that whatever could be produced by small industries were to be produced by them, and not by large-scale manufacturing units. The small industries sector was described as falling into three categories: (*a*) cottage and household industries providing self-employment to large numbers of people in rural surroundings, (*b*) industries in the 'tiny' sector with investment in equipments and machinery up to Rs. 1 lakh per unit and located in centres with less than 50 thousand people, and (*c*) small-scale industries comprising of unit with investment in plant and machinery up to Rs. 10 lakhs and in the case of ancillary units up to Rs. 15 lakhs. The policy of reservation of certain items of production for small and cottage industries, already in force since 1956, was much widened in scope. The number of such 'reserved' items was increased from 180 to 807 by May, 1978 by successive notifications. To bring about a wider dispersal of small industries, it was proposed to set up District Industries Centres in each of the nearly 450 districts in the country. These Centres were to provide under one roof all the services that small entrepreneurs would require in the initial stages, such as technical and legal know-how and credit facilities. The Policy envisaged only a limited role for large-scale industrial units. They were to provide the infrastructure for the development of small and cottage industries as well as for agriculture. Financial facilities provided by public sector financial institutions were henceforth to be used more for the small industries sector than for large-scale industries.

The Fifth Plan was terminated by the new Central Government one year earlier than its full term. It entrusted a reconstituted Planning Commission to prepare a Plan for the period 1978–83. The Draft Plan issued by the

Planning Commission envisaged industrial growth at 6 per cent per annum, but its industrial development policy aimed primarily at the creation of more employment through expansion of small industries and hence the growth objective was accorded relatively less importance. Employment in the mining and manufacturing sectors (including small and cottage industries) was calculated to increase by over 9 million man-years, absorbing over one-third of the projected increase in the labour force. However, the Plan projections could not be tested against facts, since the government lost the elections in 1980 and the Congress Party was restored to power.

After its return to power the Congress government at the Centre reviewed the industrial policy of the previous non-Congress government and decided to formulate a new policy for industrial growth. The Industrial Policy Statement of July 1980 reiterated the basic validity and workability of the industrial policy pursued by the Congress Party since 1956,' guided by the Industrial Policy Statement of that year. At the same time it aimed at obliterating the "artificial divisions between small and large-scale industry" which was, in this view, encouraged by the previous government. It introduced the concept of economic federalism which was intended to build up links between 'a nucleus plant' of a fairly large size assembling the products of small-scale plants ancillary to it, or producing inputs for small units located within its area. The nucleus plant was also expected to work for upgrading the technology of small units and creating outlets for their products. However, the three-fold classification of small units, introduced by the Policy Statement of 1977 was retained. The 'tiny' sector was re-defined as consisting of units with investment in machinery and equipment up to Rs. 2 lakhs, while the limit of investment for units in the small-scale sector was raised from Rs. 10 lakhs to Rs. 20 lakhs. In the case of ancillary units this limit was raised from Rs. 15 lakhs to Rs. 25 lakhs. Since then these limits have been further revised upwards to allow for the higher cost of machinery and to encourage the small units to adopt superior techniques of production.

Some ideas about the extent of progress achieved in the modern industrial sector can be gleaned from the following facts. In 1947 the average daily number of workers employed in the factories of the Indian Union was 22.3 lakh. This figure rose to 70.9 lakh in 1977–78. Among industries which had not yet made a beginning in 1950–51 or had only a nominal existence were: textile looms, power pumps, diesel engines, electric motors, artificial fibres, tyres and tubes, refrigerators and air-conditioners, duplicators, razor blades, screws of all sizes and types and typewriters. Very rapid rates of growth were initially registered when these industries started operations from a low (or zero) base during the First and Second Plan periods. A number of other industries in which production more than trebled in the first 15 years after 1951 (implying an average annual growth rate of over 7.5 per cent) were: steel ingots, aluminium, cement, glass, basic chemicals,

industrial alcohol, motor vehicles, bicycles, electrical lamps and fans, radio receivers, plywood, paper and refined sugar. The more-than-three-fold increase in the production of coal and a 17-fold increase in electricity generation during the same period were other indicators of industrial expansion.

The public sector owned and operated 116 industrial and mining enterprises when the Sixth Plan (1980–85) came to be drafted in 1981. Some of these enterprises, in steel and coal for example, were actually holding companies operating a number of units under one umbrella. The aggregate investment in all these enterprises amounted to over Rs. 15,420 crores. Apart from these public enterprises engaged in production, there were another 50 or so enterprises in the public sector which were concerned with construction, tourism and transport, financial and trading services and consultancy. About Rs. 3815 crores were invested in these enterprises.

Although the rate of growth of manufactured products in general decelerated to 4 per cent per annum during the 1970–80 decade, there were a few specific sectors of industrial production where production increased at more than double this rate. Typical of these sectors were: chemicals, metal products, all types of machinery and transport equipment. But the production of basic consumer goods like sugar or edible oils was barely keeping pace with the growth of population or, as in the case of cotton cloth, even failing to keep in step with population growth.

The Sixth Plan's (1980–85) industrial programmes renewed the stress on such basic industries as steel, non-ferrous metals, fertilizers, capital goods and petro-chemicals. The Plan's industrial strategy was based on the premise that the easing of supply-side infra-structural bottlenecks like shortages of power and railway transport facilities would make possible the achievement of an 8 per cent annual growth rate in industrial production, which was almost double the rate of growth achieved during 1970–80. An investment of Rs. 20,407 crores, nearly 24.3 per cent of aggregate public sector investment, was proposed to be directed towards the industrial sector along with the two major energy-producing sectors, petroleum and coal.

Measures Against Concentration of Economic Power

The Directive Principles of State Policy, as set forth in the Constitution of India adopted after Independence (in 1950) laid down that the State ought "to direct its policy towards securing ...that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment". The adoption of the 'Socialist pattern of Society' as the objective of social and economic policy, endorsed by a Resolution of Parliament in 1954, was intended to give effect to this Directive Principle. Although all industrial development schemes became subject to government authorisation, after the passing of the Industries

(Development and Regulation) Act, 1951 and a system of industrial licensing was introduced since that year, it was noticed that this had done little to check the concentration of economic power in the hands of a small number of organised business groups, specially after industrial development started gathering momentum during the Second Plan period. The rapid expansion that occurred in a number of industries after 1956–57 led to a situation in which well-established industrial firms could further expand their size and enter altogether new fields of industrial enterprise. Much of the capital for industrial expansion in the private sector was generated through internal savings within the corporate sector and these savings tended to be ploughed back in enterprises controlled by the established group of entrepreneurs. In many of the newly established industries a large scale of operation was imperative due to technological reasons. This posed the dilemma of whether to reap the economies of large-scale production by allowing firms to exercise control over larger and larger amounts of capital or to check the concentration of capital in a few hands by disallowing large-scale operations. Further, there was the consideration that many of the newly introduced industries required collaboration with foreign industrial groups and they would certainly prefer collaborating with industrial groups already established in the country. Financial and organisational constraints stood in the way of extending public enterprise to the entire set of industries requiring large-scale operation and foreign technical and financial partnership. Hence the importance of the large units in the private sector could not be deflated by expanding the operations of public sector enterprises.

When the Third Plan was framed in 1960–61, the Planning Commission recognised that the objective of securing a less uneven distribution of economic power was not being realised. The agencies responsible for authorisation and licensing of industrial schemes were, therefore, advised that "in licensing new industrial units and sanctioning the expansion of existing units, there must be considerable vigilance in permitting the growth of large existing businesses and, in the greatest measure possible, the entry of new firms should be facilitated and small and medium enterprises and cooperative organisations encouraged".[2] Similarly, public sector financial institutions were advised to see that their support to new entrants into industry and small enterprises as well as to cooperative undertakings was both speedy and adequate.

The new Indian Companies Act, introduced in 1956, was also designed as an instrument for checking inter-corporate investment and inter-locking of directorships in companies. It was expected that effective administration of the provisions contained in this Act would go a long way in checking the concentration of economic power.

The actual developments, however, gave rise to considerable criticisms

2. Planning Commission, Third Five Year Plan, 1961–66, p. 14.

of government policy in respect of industrial licensing, particularly its failure to curb industrial concentration. In 1960 the Government of India set up a Committee under the chairmanship of Prof. P.C. Mahalanobis to go into the question of industrial concentration and other aspects of the problem of economic inequality. The Report of this Committee on the Distribution of Income and Level of Living, submitted in 1964, indicated that in the industrial field the concentration of power, in the sense of command over industrial assets, was indeed growing and the top 20 industrial groups were managing in 1958 nearly three-fifths of the paid-up capital of all private sector companies.

A more thorough-going investigation into the share of the dominant business groups in industrial activities was carried out by the Monopolies Inquiry Commission set up in 1965. The Commission's Report revealed that 75 large business houses, having ultimate power of decision-making over 1536 companies, exercised control over 44.1 per cent of the paid-up capital of all companies in the private sector, excluding banking companies. Their command over all types of assets held by such companies was even higher and was estimated at 46.5 per cent. The Commission also went into the question of market domination and for this purpose studied product-wise concentration. The product concentration ratio in respect of any specific product was regarded as 'high' if the three most important sellers had a 75 per cent or larger share in total sales. If this share was between 60 and 75 per cent, the concentration ratio was regarded as 'medium' and if it was between 50 and 60 per cent it was 'low'. The Commission made a study of 100 industrial products and found that high or at least medium concentration ratios were prevalent in respect of most industrial products whose production had recorded high rates of growth since the early days of planned industrial development. The Commission, however, expressed the view that concentration as such need not be considered as a menace. Measures against concentration assume importance only when such concentration leads to restricted output, unreasonably high prices, inferior quality of products and other undesirable practices arising out of the use of monopoly power.

Following the recommendations of the Monopolies Inquiry Commission, the Monopolies and Restrictive Trade Practices (MRTP) Act of 1969 was drawn up. The Act introduces the concept of a 'Business House' which consists of a group of inter-connected units. A business house is considered 'large' when the aggregate value of assets of all inter-connected units under its control exceeds Rs. 20 crores.[3] The Act also defines 'Dominant Undertakings' as those units which own assets above Rs. 1 crore and which, along with its inter-connected undertakings, provides for at least one-third of the

3. This limit has been raised to Rs. 100 crores as the market value of assets rose as a result of inflation.

total domestic supply of a specific product. Both 'Large Industrial Houses and Dominant Undertakings' are required to get themselves registered with the authorities administering the MRTP Act. The effect of such registration is that the undertakings so registered have to take special permission from the MRTP administration for any expansion, diversification, merger or take-over scheme that they may want to initiate.

A permanent statutory commission (MRTP Commission) with quasi-judicial authority was set up under this Act in 1970 to go into all issues relating to exercise of monopoly power in a manner that is "prejudicial to the public interest". Practices like collusive price fixation, exclusive dealership contracts, resale price maintenance and secret understanding among competitors regarding market-sharing are referred to the Commission for its adjudication and final recommendations. According to recent indications of policy in this respect, MRTP companies will not be ordinarily permitted to set up industries which are not explicitly made accessible to them.[4] But exceptions will be made in those cases where the company accepts an obligation to export at least 60 per cent of its production. An MRTP company will not also be permitted to collaborate with State agencies in setting up in the 'joint sector' any industry from which it is otherwise excluded.

Since the operation of the government's industrial licensing policy was believed to be largely responsible for the growing concentration of industrial assets in the country, an enquiry into the industrial licensing policy was also ordered in 1967. The Industrial Licensing Policy Enquiry Committee under the Chairmanship of Subimal Dutt, a senior Indian Civil Service official, was asked to review the working of the industrial licensing system in the country and to suggest measures for its improved functioning. In its Report, submitted in July 1969, the Committee roundly condemned the licensing authorities for being too generous in granting industrial licences to a limited number of big and established business houses and observed that "(the) consideration of preventing monopoly does not seem to have entered the picture at all". There were many cases in which licences were pre-empted by some established group but the corresponding projects were never undertaken; as a result competitors were prevented from entering an industry and output was not allowed to expand. In other cases more capacity was licensed than was justified on technical or economic grounds.

The Committee recommended that large industrial houses, which were then 73 in number on the basis of criteria like the amount of fixed assets controlled, should be made to confine their activities only to a few areas of basic, strategic and critical importance. The Committee described this as the 'core' sector. In addition, any industrial project requiring heavy investment, that is , an investment of over Rs. 5 crores would also remain open

4. 24 such industrial groups were indicated in 1982.

to the large industrial houses. It was also held that the public and private sectors could work together for the development of certain industries, specially those where foreign collaboration was regarded as indispensable. Such industries could then be said to belong to 'the joint sector'. For all other industrial investment proposals requiring a licence, special consideration was to be given to medium and small entrepreneurs.

The industrial licensing policy has been modified several times after 1970, generally on the lines recommended by the Dutt Committee. Liberalisation in licensing provisions has taken the following forms: the limit of investment up to which licences are not required has been raised, in some cases automatic growth in licensed capacity has been provided for (usually up to 25 per cent in five years), certain industries exploring new technological processes have been altogether exempted from the licensing regulations and the procedures for the processing of applications for industrial licences have been considerably simplified. Certain steps have also been taken to monitor the implementation of the projects for which licences have been issued. Production for exports is not counted in the licensed capacity of an undertaking, nor is it taken into account in determining 'dominance' of an undertaking under the MRTP Act. Certain special facilities have been introduced to encourage non-resident Indians to instal industrial capacity in India. For certain industrial expansion schemes it is at present enough to get registered with the Secretariat for Industrial Approvals and licensing has been dispensed with.

De-licensing and liberalisation in the policy of issuing licences are both useful measures to step up the rate of industrial growth which had decelerated in the 1970s. But the extent to which small and medium entrepreneurs will be induced by these policies to enter the industrial field, and the degree by which the concentration of industrial assets and activities will diminish as a result of these policies is not very clear at the moment.

Foreign Capital and Technical Collaboration in the Post-Independence Period

In the Industrial Policy Resolution of 1948, adopted shortly after Independence the Government of India assured foreign investors who might be interested in investing in India that they would not be discriminated against in any way, and in case of nationalisation of their undertakings they would be adequately compensated. But private investors in foreign countries showed little interest in India. There was, on the other hand, a tendency for foreign capital, invested in India before 1947, to be repatriated and this gave rise to some payments problem immediately after Independence. As industrialisation proceeded under the Five Year Plans the need for imports of machinery, equipments, minerals and mineral oil began to grow, the balance of trade turned adverse and foreign exchange reserves dwindled to

very low levels by 1957–58.[5] Inflow of foreign funds, either in the form of inter-government loans (including loans from international lending agencies) or private equity participation, then came to be looked upon as a measure of support to the process of industrialisation of the country. Foreign capital, it came to be argued, was helpful in the short run to get over the hump on the way to self-reliant development. As the Planning Commission put it in 1961, "Development effort in India over the Third and Fourth Plans has to concentrate on expansion of capital goods and machine building industries... on a scale that would enable the country to build up in this period sufficient capacity to produce domestically the bulk of the capital goods and machinery that it will require in subsequent periods" and hence depending on foreign capital for a relatively short period was considered not only unavoidable, but also judicious.

While the flow of inter-government loans and special concessional loans from international financial institutions increased after the foreign exchange crisis of 1958–59, private capital inflow was also stimulated in consequence of a number of collaboration agreements negotiated in the late 1950s, and subsequently, between Indian and foreign industrial groups. A number of foreign companies also became interested in setting up branches or establishing subsidiary companies in India as restrictions on imports were tightened up. Such subsidiary companies usually had, some degree of Indian participation, but the majority of shares and control were retained by the parent foreign company. By 1978–79 these subsidiary companies had a paid-up capital of nearly Rs. 360 crores, of which almost three-fifths were contributed by the foreign controlling interests. The assets of foreign subsidiaries increased by about 44 per cent during 1959–76.

Private foreign investment played a significant role in the absorption of foreign technology in India during the Second and Third Plan periods in particular. It also helped in easing the burden of payments in foreign exchange for imported machinery and equipments. However, when account is taken of remittances of dividends, royalty payments, licence fees and salaries of foreign technicians, the net gain in foreign exchange does not appear as striking. For the period 1948–61, in fact, one study reveals that gross foreign investment of Rs. 247.1 crores was far outweighed by foreign exchange payments on account of remittances of profits and royalty payments etc. amounting to Rs. 577.3 crores.[6] The situation in this respect improved to some extent as the foreign exchange earnings of such companies increased in later years. But the companies showed little inclination to transfer their control to Indian hands, which was the declared aim of government policy. Accordingly by an amendment of the Foreign

5. 'Foreign exchange reserves fell sharply by Rs. 481 crores in the first two years of the Second Plan' (Third FYP, p. 107).

6. Kidron, M., as cited in Deepak Lal—*Appraising Foreign Investment in India*, p. 114.

Exchange Regulation Act (FERA) in 1973 the government sought to increase Indian equity participation in such companies as well as to reduce the outflow of foreign exchange caused by predominant foreign ownership. Section 29 of the Act provided that all companies incorporated outside India and Indian companies having more than 40 per cent non-resident interest would have to seek fresh permission from the Reserve Bank of India to carry on their existing business activities in India. Steps were taken by the RBI through this process to convert branches of foreign companies into Indian companies with foreign holdings usually of not more than 40 per cent. though higher shares were allowed in the case of companies trading in certain special products or undertaking specific export commitments. Similarly companies already incorporated in India. but with more than 40 per cent non-resident interest were also required to reduce their foreign holdings, again usually to 40 per cent. The FERA companies, as companies with foreign equity participation are now usually called, are required to restrict their activities to certain specified industrial activities, just like the large industrial houses and dominant undertakings incorporated in India.

Special Agencies for Promotion of Small and Village Industries

We have seen earlier how traditional handicrafts of the country were either destroyed or forced to lead a moribund existence because of the unrestricted free trade policy pursued by the British rulers in India. The revival of village industries for the proper utilisation of rural manpower was stressed in the economic resolutions of the Indian National Congress long before the party came to power in 1947. The handicrafts were relied upon to supplement, because of their employment-generating capacity, the performance of machine-building industries which were given the highest priority in Indian planning strategy, as framed by Professor P.C. Mahalanobis in the early 1950s. They were also regarded as capable of turning out additional outputs of essential consumer goods like cloth and edible oils by bringing into fuller use their under-utilised tools and appliances. This, it was believed, would check the rise in consumer good prices which the Mahalanobis planning strategy might otherwise bring about.

Following this line of thinking, the Planning Commission set up in June 1955 a committee under the Chairmanship of Professor D.G. Karve, a well-known economist, to examine the problems facing small-scale and cottage industries in the country and to draw up a scheme so that these industries could satisfy a large proportion of the increased demand for consumer goods in common use, increase employment opportunities and generally adopt the co-operative form of organisation in production and marketing. The Report of this Village and Small-Scale Industries (Second Five Year Plan) Committee recommended a substantial stepping up of Plan outlay on the

development of this category of industries, if they were to play the role expected of them. During the First Plan about Rs. 31 crores were spent on village and small industries and a Khadi and Village Industries Commission was set up. In the Second Plan the outlay for this purpose was proposed to be raised to nearly Rs. 260 crores and the additional employment potential was expected to be around 50 lakhs. The Committee suggested in their Report that certain curbs must be put on the output of factories so that the village and small-scale industries did not have to face unequal competition from mills and factories. It was believed that in the long run, as the small industries improved their technology, they would be able to match the performance of the larger units and dispense with special measures of assistance and protection.

For the development of different types of cottage and village-based industries special Boards were set up during the First and Second Plan periods. The more important among these are the All India Handicrafts Board, All India Handloom Board, Coir Board, Central Silk Board and the State Khadi and Village Industries Boards. The small industries, which use more modern technology and generally run on electricity as well as employ some hired workers, can draw upon the assistance of such specialised agencies as the Small Industries Development Corporation and the National Small Industries Corporation both of which were set up in the period following the Karve Committee's deliberations.[7] Plan outlay for the development of small and village industries reached its high water-mark during the Second Plan when it was 4 per cent of realised aggregate Plan outlay. The short-lived non-Congress coalition government at the Centre put, during 1977–79, a good deal of emphasis on the rehabilitation of the small and cottage industries. Despite this emphasis in their policy, the actual outlay on the development of these industries was only 1.3 per cent of the aggregate Plan outlay during 1974–78. The Sixth Plan proposed to raise the outlay under this heading to 1.8 per cent. The general experience has been that even the funds allotted for development of the small industries and handicrafts cannot be spent fully or with full advantage because of organisational lapses. Lack of reliable statistical data in respect of the small and cottage industries is another handicap in properly planning for their development. The progress in respect of diffusion of small-scale enterprise in rural areas is still very limited. One survey revealed that in 1976 nearly two-thirds of registered small-scale units in the country were located in the industrially advanced States and around Delhi.[8] Among small scale units financially assisted by the commercial banks, the really 'tiny' units were conspicuous by their absence According to a Reserve Bank of India

7. The organisational forms were suggested by a Ford Foundation team which studied the problems of India's small industries in 1959.

8. Sixth Five Year Plan, p. 188.

study 60 per cent of the credit flow to small scale industries was availed of by only 11 per cent of the small units and these were the relatively bigger units. In spite of the existence of a large number of agencies to help the artisans and small entrepreneurs, the deployment of credit for the development of this sector has been small. However, better marketing arrangements have been of some help in marketing the products of village industries and handicrafts both inside the country and abroad. Exports from the village and small industries sector have been recently estimated at about one-third of total exports from the Indian Union.

Specialised Institutions for Industrial Financing

During the entire period of British rule the State followed a policy of almost complete passivity so far as modern industrial development was concerned. Industries like jute and paper attracted some foreign (British) investment, while industries which grew up mainly on the basis of indigenous capital investment, such as cotton textiles or iron and steel, had to raise capital through sales of shares or debentures and occasionally also by taking deposits for relatively short period from the public. The State failed to introduce comprehensive arrangements to improve the long-term financing of industrial projects, although under the State Aid to Industries Acts some token advances used to be made every year to relatively minor industrial enterprises. For a long time it was being felt that a capital market in the proper sense of the term could not develop in India unless, in the initial stages, the State came forward to support the industrial borrowers by underwriting or standing as guarantor for their loans. However, nothing was done in this respect before Independence.

The first State venture in the field of industrial finance took shape in 1948 when the Industrial Finance Corporation of India (IFCI) was set up. Out of its initial paid-up capital, Rs. 5 crores, the Government of India subscribed Rs. 1 crore. The remaining shares were allotted to the Reserve Bank of India (which had not been nationalised then), the more important joint-stock banks, insurance companies, investment trusts and co-operative banks. The shares received guarantee of a minimum dividend, 2½ per cent free of tax, from the Government of India. The Corporation was empowered to issue its own bonds and debentures and to accept long-term deposits from the public, subject to the condition that its total liabilities on this and other accounts could not exceed five times its capital and reserves. Later amendments have further added to the total resources of the Corporation.

The IFCI can guarantee loans raised by industrial concerns for periods not exceeding 25 years, can underwrite shares or debentures and hold them before selling for periods up to 7 years, and grant advances to industrial borrowers against their fixed assets for periods up to 25 years. Originally

it was debarred from acquiring shares or debentures, but this was later permitted in suitable cases. There are limits to be observed regarding the maximum loan granted to an individual borrower. Only public limited companies and cooperative societies engaged in specified industrial activities were made eligible to borrow from the Corporation.

In 1951 the State Financial Corporations (SFC) Act, adopted by the Indian Parliament, enabled the States in India to set up their own financial institutions for helping medium and small industries of regional, rather than national, importance. State governments subscribed to a portion of the share capital of an SFC; the remaining shares were allotted to the Reserve Bank, joint-stock and co-operative banks, insurance companies and the like. However, private investors could also hold shares of an SFC subject to the limit of 25 per cent of its total share capital.[9] An SFC can grant advances for periods not exceeding 20 years. There are limits to the amount of loan that can be granted to a single borrower. A minimum dividend guarantee is provided by the State government concerned.

The National Industrial Development Corporation (NIDC) set up in 1954, was a fully State-owned institution with a paid-up capital of Rs. 10 lakhs only. Its primary objective was not the financing, but the promotion, of new industries according to priorities laid down in the Five Year Plans. Additional finance for schemes entrusted to NIDC by the Planning Commission was to be made available by the government.

State governments have also set up State Industrial Development Corporations on almost the same pattern as the NIDC. These State Corporations are entrusted with the task of promoting industrial development schemes in the State by attracting new private enterprise through offer of easy loans, subscription to shares and other suitable means.

The Industrial Credit and Investment Corporation of India (ICICI) was brought into existence in 1955 as a collaborative venture of Indian and foreign banks and other institutions, but was provided loan assistance by the Government of India. The World Bank (International Bank for Reconstruction and Development) also provided a credit line that could go up to 10 million U.S. dollars. The ICICI grants loans to industrial concerns as well as buys their shares and debentures. It is also equipped to give technical and managerial assistance and to arrange for foreign loans in cases where industrial concerns decide to go in for such loans. The Corporation was set on foot with a subscribed capital of Rs. 22 crores, with powers to augment its resources through borrowing.

The system of financing of industrial development schemes was further strengthened when the Industrial Development Bank of India (IDBI) was set up in July 1964 as a wholly-owned subsidiary of the Reserve Bank

9. The share capital varies from State to State, but is usually between Rs. 50 lakhs and Rs. 5 crores.

of India. It was converted into an independent institution in 1976. With more resources than any of the other industrial financing institutions, it has now become the premier term-lending institution for large-scale industries in India. It gives direct loans to industrial borrowers as well as re-finances loans granted by other institutions to such borrowers, thus taking over re-financing functions from the Re-Finance Corporation for Industry, established earlier. Loans are granted also to exporters and export-financing institutions. It is also authorised to subscribe to shares and debentures of IFCI, SFCs and other approved financial institutions, thus adding to their working funds.

Another institution, designed to channellise private savings into industrial investment, and named the Unit Trust of India, was established in February 1964 with capital (Rs. 50 crores in 1976) contributed by the Reserve Bank, important joint-stock banks of the country and other financial institutions. It sells 'Units' in relatively small denominations and invests the funds so acquired, along with its own initial capital, in industrial securities. The holders of 'Units' receive a 'dividend' which depends on the profits (including capital gains) earned by the Trust.

In 1980–81, the amounts of loans sanctioned by the above-mentioned financial institutions were. IFC, Rs. 212.75 crores;[10] ICICI, Rs. 591.99 crores; IDBI, Rs. 1160.15 crores; and SFCs, Rs. 383.29 crores. In the same year the Unit Trust of India held nearly Rs. 430 crores in various forms of securities on behalf of unit-holders. The Life Insurance Corporation of India as well as the General Insurance Corporation also invest a certain portion of their funds in industrial securities. Ordinarily such investment would amount to nearly Rs. 100 crores per year. The vital importance of all these financial institutions in the capital market can be realised from the fact that in the year ending March 31, 1981 public subscription to companies issuing shares was only about Rs. 65 crores. Studies of company finances in India invariably point to a rising trend in the ratio of debt to equity over the years. This ratio is somewhat higher for the bigger companies than for the smaller ones, which lends some justification to the view that the larger units under private ownership are being allowed to expand with soft loans from semi-public financial institutions. Normally the generation of internal funds and ploughing back of profits helps in financing no more than 30 per cent of the cost of expansion of existing companies in the private sector.

10. For year ending June 1981.

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A History of India's Foreign Trade and Trade Policies

In the early days of the British East India Company, which virtually monopolised India's foreign trade after ousting the rival Dutch, French, Danish and Portuguese traders, exports from India consisted largely of calico and spices while imports into India consisted very largely of bullion (gold and silver). The English traders could find scarcely anything to sell in India because woollen goods, at that time the most important manufactured product in England, had little demand in India. It was no wonder that very soon a cry was raised in England condemning the East India Company's activities which resulted in the draining off of bullion from that country. Towards the end of the 17th century agitation in England led to the imposition of heavy import duties on India's calicoes and even to complete banning of imports of certain varieties. The end of the 18th century saw the coming of a 'textile revolution' in England, enabling that country to produce finer cotton cloth at comparatively low prices, which completely reversed the nature of India's trade with England within a few years. By the middle of the 19th century, imports of cotton piecegoods represented about half the total imports of foreign merchandise into India.[1] At the same time that the Indian cotton handicrafts were being ruined by competition of British factory goods, raw cotton from India found its way to the British market, aided by the fact that Britain became eager to reduce her extreme dependence on American sources of supply of cotton. The expansion of exports of raw cotton and other raw materials from India received further fillip from (*a*) the opening of the Indian countryside after the construction of railways, and (*b*) the shortening of the sea-route to England by about 3,000 miles after the construction of the Suez canal (1869).[2] Apart from

1. Jathar and Beri, *Indian Economics*, Vol. II (1941), p. 230, citing Cotton, *Handbook of Commercial Information for India*, p. 95.

2. The following figures give some idea of the expansion in India's foreign trade after 1869:

Period	*Annual Average Exports (Rs. Cr.)*	*Annual Average Imports (Rs. Cr.)*
1864–65 to 1868–69	55.86	31.70
1894–95 to 1898–99	107.53	73.67
1924–25 to 1928–29	353.51	251.02

cotton, other raw materials that entered India's export trade included jute, oilseeds, hides and skin, foodstuffs like wheat and rice and beverages like tea. To stimulate exports most export duties hitherto prevailing were abolished in 1874. Internal barriers to trade such as transit duties had been already swept away during 1836–53.

On the imports side manufactured articles of all sorts predominated. Initially these were from England, the original home of the modern industrial revolution, but subsequently the sources were diversified and Germany, the U.S.A. and Japan figured in our list of suppliers of manufactured goods. It is true that a cotton textiles industry came into existence in India as early as 1854, but it could not grow fast enough to supply all domestic needs. Free inflow of foreign manufactured imports was facilitated by the doctrinaire abolition of almost all import duties in 1882.

The monopoly of the East India Company in India's foreign commerce was ended by the Charter Act of 1813. The requirement that all goods entering or leaving India must use British shipping was removed in the second half of the nineteenth century. Although the field was then left open to other nations to enter into closer trading relations with India, British trading links were easily the most important throughout the period before 1947. This is explained by the predominance of British managing agencies in Indian industries, the stranglehold of British commercial and shipping interests and by the policy decisions taken, specially after 1932, to discriminate in favour of Britain and against other trading partners.[3]

The growth of Indian exports since 1850 has not followed an even pace. There was an acceleration in the pace in the 1860s following the Civil War in the U.S.A. which brought about a diversion of British cotton purchases from the U.S.A. to India. In the last quarter of the 19th century the pace of export growth was relatively slow. Droughts and famines in the Indian countryside, disturbances in the centres of trade (*e.g.*, the plague at Bombay in 1896), uncertainties about the external value of the Rupee after 1873,[4] all these combined to check the pace of expansion. The first fourteen years of the twentieth century, however, saw a doubling of the value of Indian exports. Thanks to the completion of huge irrigation works in the Punjab and Sind, large agricultural surpluses became the order of the day. The stability in the external value of the Rupee removed the previously prevailing uncertainties. The emergence of newly industrialising countries like Germany and Japan added to the demand for Indian raw materials. Whereas the quinquennial average of exports from India was below Rs. 110 crores in the five years ending in 1898–99, it reached a figure of Rs. 224 crores in the five years ending in 1913–14.

On an average the growth of imports was at a slightly faster rate than

3. See page 144.
4. See pages 200 ff.

the growth of exports throughout the period between 1865 and 1914. While exports increased fourfold during this period, imports went up nearly five-fold. There was intense competition for the sale of manufactured goods in the Indian market between England and her industrial rivals like Germany and Japan. Towards the end of the nineteenth century both these countries established branches of their own national banks in India[5] and developed their national shipping services in the Indian ocean. The United States of America neglected for a long time the development of direct trading relations with India. It was only after the First World War that she entered the fray.

The initial years of the First World War saw a setback in exports. Normal trade channels were disrupted, many of India's trade partners in Europe were invaded or declared enemy countries, shipping became subjected to increasing risks leading to a rise in freights and insurance" costs, and Britain, the most important trading partner, had to alter her production pattern to suit the needs of the War. By 1916–17, however, the demand for Indian exports once again reached pre-war levels. Demands for jute bags increased to meet the needs of trench warfare; demand for hides and skins increased to turn out a larger number of boots for the soldiers. When the war ended, the value of exports was slightly above the pre-war level at currently prevailing prices. But reckoned in prices of 1913–14 exports at the close of the War were nearly 33 per cent below the pre-war level.

During the years of the First World War the quantum of Indian imports fell even more rapidly than that of exports. At the close of the War imports (at 1913–14 prices) were less than 40 per cent of the pre-war level. The fact that England, the most important source of manufactured imports for India, was engaged in a life-and-death struggle very largely explains the sharp falling off of imports into India. Germany, now an enemy country, could not be counted upon as a source of supplies. Japan filled in some of the gaps left by the withdrawal of England and Germany, but she was not in a position to supply more than a fraction of India's import requirements.

After the War the pent-up demand for manufactured goods together with restoration of normal transport channels and the re-emergence of the former enemy countries brought about a sharp spurt in imports. Demand for exports, on the other hand, fell off immediately after the War ended. In the period 1920–23 the value of exports remained below the 1919–20 level, while imports, after rising sharply in 1920–21, gradually fell to more normal levels. After 1923 exports rose faster than imports for two or three years, but the pace of export expansion slackened appreciably after 1925–26. The demand for raw materials from India was reviving in Europe and else-

5. The Deutsche Asiatische Bank by Germany and the Yokohama Specie Bank by Japan.

where but domestic problems such as high prices, labour unrest, want of railway facilities and uncertainty about the external value of the Rupee prevented faster expansion of exports. Important markets were, however, lost because of war devastation in some of the Central European countries. Monsoons in India were not too good in the immediate post-war years and as a precautionary measure the Government of India adopted a policy of embargo on the export of foodstuffs after 1918–19. For all these reasons the growth of Indian exports in the first post-World-War I decade was insignificant, the value of exports in 1928–29 being almost at the same level as in 1919–20 (about Rs. 340 crores). Coming on top of this stagnation in exports the world-wide depression in the prices of agricultural products after 1929 hit Indian export producers (mainly, agriculturists) very hard indeed. Not until 1936–37 did the prices of India's agricultural exports recover sufficiently. But export values had resumed their upward trend a few years earlier, *viz.*, in 1933–34[6] Along with exports the value of imports also fell during the period of depression, but the rate of decline was not as great as in the case of exports. Imports fell both because of the sharp fall in the purchasing power of Indian consumers following the general decline in export prices and incomes and also because the home output of some manufactured imports (*e.g.*, textiles, sugar) had been growing faster after the grant of protection to a number of Indian industries during 1924–32.[7]

The process of recovery had not gone far when a sudden set-back to expansion occurred in the form of the American trade 'recession' of 1937. The prices of raw materials once again tended to fall leading to a sharp decline in the value of Indian exports in the years 1937–38 and 1938–39. At this time the world was again on the verge of another World War and commodity markets began to reflect the uncertainty and nervousness experienced by transactors in all countries. Although general war preparations opened up fresh avenues of demand for some of India's exportables, generally prices remained adverse to Indian exporters. At the same time the preoccupation of Japan with the China war led her to reduce her purchases of raw cotton in the Indian market. The upshot of all this was that the value of Indian exports in 1938–39 was only half of that recorded in 1928–29, while imports stood at 62 per cent of the 1928–29 level.[8]

After the outbreak of the Second World War (September 1939) prices of Indian exports began to rise in European markets. The War created

6. Trade figures for the period of the Great Depression are given below:

Year	*Exports (Rs. Cr.)*	*Imports (Rs. Cr.)*
1928–29	339.15	263.40
1929–30	318.99	249.71
1930–31	226.50	173.06
1931–32	161.20	130.04
1932–33	136.07	135.02
1933–34	151.17	117.30

7. See pp. 91–92.

8. The quantum of exports, however, increased.

additional demand for Indian raw materials. But owing to the difficulties of suddenly expanding domestic production and the shortage of shipping, the volume of Indian exports did not expand as fast as the demand situation warranted. Trade with Germany and other countries in the opposite camp, of course, ceased with the outbreak of the War. But this was more than made good by the additional trade with England and the countries in the British camp. As the War proceeded and particularly as the Japanese threat to India developed, the Government of India felt the need of conserving the domestic supply of certain kinds of exportables and a system of Export Trade Control was instituted.

Imports also came to be affected adversely by the preoccupation of the European manufacturing countries with war production. The necessity of conserving shipping space led to the restriction of imports and some 68 articles of import were subjected to Import Control orders in May 1940. Indian manufactured goods began to be exported in larger amounts to her neighbouring countries in Asia as the inflow of European manufactures into these countries dwindled as a consequence of the War.

As India's trade with Europe declined, the necessity was felt for developing alternative markets for Indian exports and alternative sources of supply for essential manufactured goods. The Gregory-Meek Mission[9] was sent to the United States in July 1940 to explore possibilities of Indo-American trade. However, as America was more than self-sufficient in some of the products (*e.g.*, cotton) which India was in a position to supply her and as many of the Latin American countries were already supplying the American market, Indian exports were found to have little demand there. The only major products which might receive larger orders from the American market were manganese, mica and rubber. Accordingly the Mission's report came to the conclusion that the American market could be explored in India's favour only if suitable consumer products were developed and marketed there. Since this would call for a good deal of watchfulness and marketing initiative, the report stressed the need of exploring markets in other parts of the globe (*e.g.*, other countries of Asia and Africa).

To deal with the problems created for Indian exports by the sudden outbreak of the War, the Government of India set up in May 1940 an Export Advisory Council of 22 members representing various commercial and industrial interests. The Commerce Member of the Viceroy's Executive Council was the Chairman of this Council. The business of the Council included the exploration of alternative markets for Indian experts, with particular emphasis on the expansion of manufactured exports.

As the Second World War came to an end, the demand for imports which could not so long be satisfied due to the war-time shortages and

9. The Mission consisted of Dr. T.E. Gregory and Sir David Meek, both belonging to the Government of India.

restrictions began to assert itself. Exports also began to recover as some of the disrupted trading links came to be restored. Immediately before the Independence (and partition) of the country, in 1946–47, exports of merchandise stood at slightly above Rs. 320 crores while imports were recorded at Rs. 330 crores. Including net imports of gold and silver, total imports would be put at a higher figure, *viz.*, Rs. 361 crores. This adverse balance of visible trade, attributable to temporary post-war factors, became a conspicuous feature of the Indian economy after the partition.

The partition of the country reduced the capacity of the Indian Union to export articles like raw cotton, raw jute, hides and skins. It became necessary for India to import these articles in order to meet the raw material requirements of Indian industries. The country's dependence on food imports also increased as a result of partition.

Since the third decade of the nineteenth century India's exports have consisted primarily of foodstuffs and raw materials. It is true that as industrial development gathered momentum in India, some manufactured articles, specially jute textile, began to figure in the list of exports. Even before the First World War the percentage of manufactured exports in total exports was gradually increasing. During that War exports of raw materials to Europe declined and opportunity arose for selling manufactured exports in Asian and African markets due to the temporary withdrawal of European countries from these markets. As a result the percentage of manufactured exports to total exports rose from 22.4 per cent in 1913–14 to 36.6 per cent in 1918–19.[10] This relative expansion in manufactured exports could not, however, be maintained after the War when industrially advanced European countries returned to the world markets. Countries like Japan, the U.S.A. and Canada utilised the opportunity created by the War to capture a larger share of the world market for manufactures. India reaped little permanent advantage, because her industrial base was too narrow and industrial productivity remained at an extremely low level.

With the grant of discriminating protection to Indian industries in 1924–25, domestic production of industrial goods increased, leading to certain significant changes in the composition of India's external trade. The Indian Fiscal Commission of 1949–50 estimated that India's export trade changed its composition between 1920 and 1940 as follows:

Nature of Commodities exported	*Five-yearly average percentages*	
	1920–25	*1935–40*
Food, drink and tobacco	24.0	21.8
Raw materials	50.2	46.7
Manufactured articles	24.8	30.0

10. Jathar and Beri, *Indian Economics*, Vol. II (1941), p. 235.

On the imports side the changes were more marked, since in the early stages of industrialisation it is generally easier to manufacture substitutes for manufactured imports at home than to sell fabricated exports abroad. The estimates of the Fiscal Commission relating to changes in the composition of Indian imports during the same period are given below:

Nature of commodities imported	*Five-yearly average percentages* 1920–25	1935–40
Food, drink and tobacco	14.1	14.0
Raw materials	7.4	19.8
Manufactured articles	76.7	64.4

Dividing 'manufactured articles' into two groups, consumer goods 'and capital goods, the Fiscal Commission could bring out the fact that imports of manufactured consumer goods had declined from 54 per cent of total imports in 1925–26 to as little as 33 per cent in 1938–39. Imports of manufactured capital goods, however, increased during the same period from 23.2 to 25.9 per cent of total imports. These figures suggest that immediately prior to the Second World War, the share of manufactured goods in total imports had fallen to about 60 per cent of total imports.

The Second World War brought to India once again an opportunity of expanding industrial production and, in fact, the index of production of large-scale industries rose from 102.7 in 1939 to 120.0 in 1945. As already stated, the inflow of foreign goods into the country was hampered by factors arising out of the War and Indian factories were increasingly called upon to meet requirements of manufactured goods both within the country and abroad. The effect of the Second World War on the pattern of external trade will be seen in the following figures.[11]

Commodity group	*Share in total exports* 1938–39	1946–47	*Share in total imports* 1938–39	1946–47
Food, drink and tobacco	24.0	19.5	15.8	33.8
Raw materials	45.0	31.0	21.0	19.9
Manufactured articles	29.3	48.0	60.9	44.4

The partition brought about considerable changes in the composition of external trade for the Indian Union. The raw-material producing parts of undivided India having been mostly included in Pakistan, the Indian

11. Planning Commission, *First Five-Year Plan*, p. 454.

Union faced a deficit in raw materials and foodstuffs and had to obtain them by import. The proportion of manufactured exports went up not because of any sharp increase in the foreign sales of manufactured goods, but because the exports of raw materials fell off sharply. The following figures give us the composition of India's exports and imports in 1948–49, the first full year after the partition:

Commodity group	*Share of total exports in 1948–49*	*Share of total imports in 1948–49*
Food, drink and tobacco	21.0	24.3
Raw materials	23.5	30.7
Manufactured articles	55.1	44.3

In 1938–39 jute manufactures, cotton manufactures and tea accounted for about 35 per cent of India's total exports. Raw materials (cotton, jute, hides and skins, oilseeds, etc.) constituted about 40 per cent of exports. Ten years later, in 1948–49, the share of the former group rose to over 56 per cent, while that of the latter group fell below 15 per cent. This brings out very clearly the almost drastic change in the nature of India's (*i.e.*, the Indian Union's) principal exports following the partition. Corresponding changes were noticeable on the imports side.[12,13]

12. Planning Commission, *op. cit.*, p. 455.
13. Figures for India's principal export and import commodities for 1938–39 and 1950–51 are given below (*in crores of Rs.*):

Exports	*1938–39*	*1950–51*	
Cotton, raw and waste	24.67	4.94	
Jute, raw	13.40	..	
Hides and skins, raw	3.85	34.91	
Leather	5.28	..	
Jute manufactures	26.26	108.30	
Cotton manufactures	7.12	118.00	
Tea	23.29	79.87	
TOTAL (*including other items*)	162.79	596.79	
Imports	*1938–39*	*1950–51*	
Cotton and cotton goods	22.66	104.12	(of which raw
Grains, pulses and flour	13.76	80.76	cotton 100.77)
Machinery and mill-work	19.05	96.97	
Metals and ores	10.87	47.05	
Oils	15.62	41.48	
TOTAL (*including other items*)	152.62	623.36	

Source: for 1938–39, *Review of the Trade of India (1939–40)*;
for 1950–51, *Accounts Relating to the Foreign Trade and Navigation of India.*

The share of the United Kingdom in India's foreign trade has changed remarkably over the years as competitors like Germany, the U.S.A. and Japan built up commercial ties with India. At the close of the nineteenth century the United Kingdom supplied about 69 per cent of Indian imports.[14] By 1913–14 inroads into the Indian market had been made by the late-comers in industrial development. As the U.K.'s share fell to 64.1 per cent, Germany increased her share from 2.4 to 6.9 per cent, the U.S.A. from 1.7 to 2.6 per cent and Japan from only 0.6 per cent to an equal share with the U.S.A. The export trade of India has always been more diversified than the import trade: the share of the U.K. was only 29 per cent of total exports in the early years of the twentieth century. By 1914 this share was further reduced to 24 per cent. Continental European countries which took about 25 per cent of Indian exports raised their share during the same time to 29 per cent. The share of the Far Eastern countries fell from 24 to 17 per cent owing to the loss of trade in opium and cotton and silk yarn. The United States raised her share from 7 to 9 per cent, while the rest of the world absorbed in 1914 about 21 per cent of Indian exports as compared with only 15 per cent fifteen years earlier. Individually Germany and Japan both came into closer relationship with India as customers of Indian exports. Simultaneously the Chinese market for Indian exports shrank in size.

During the First World War the U.K., owing to her preoccupation with the War, lost further in the Indian market, her share in Indian imports in 1918–19 being as small as 45.5 per cent. On the exports side, however, more goods were diverted to the British market in order to meet war-time requirements; the share of the U.K. in 1918–19 rose to above 29 per cent. The gap left by the decline of the U.K.'s share in Indian imports was filled up by Japan and the United States. These countries also emerged as important buyers of Indian exports as Germany and several other countries of continental Europe dropped out. The net result of the War was thus to restrict the geographical coverage of the market for Indian exports. As competition for Indian export products declined to some extent, prices received abroad for such products also became relatively unfavourable. The terms of international trade moved against India.

After the First World War the U.K.'s share in Indian imports recovered for a short while. But that country's domestic troubles, the increasing competition from Germany and Japan and the 'boycott' movement against British goods organised by political leaders in India, all these began to undermine the position of the U.K. as a supplier of Indian imports. In 1931–32 the share of the U.K. in Indian imports fell to 35.5 per cent. The Ottawa Agreement of 1932 which came into effect on 1st January, 1933 provided for preferential tariff treatment for British goods in the Indian

14. Jathar and Beri, *op. cit.*, p. 245.

market on a reciprocal basis. For several years after this Agreement, the U.K.'s share in Indian imports improved, rising to 41.7 per cent in 1933–34. But immediately before the Second World War her position had once again slided back, her share in total imports into India being only 30.5 per cent in 1938–39. Germany and Japan were both quite aggressive as sellers in the Indian market after the First World War; the former's share in imports rose to 8.5 per cent in 1938–39.

In respect of exports from India the post-war years saw a drifting away of sales from the U.K. towards the continental countries of Europe. The U.K.'s share in exports fell from a war-time average of 31.1 per cent to the post-war average of 24.2 per cent.[15] One effect of the Ottawa Agreement, however, was to divert Indian exports towards the U.K. and other countries of the British Empire. The U.K.'s share in Indian exports rose to 34.3 per cent in 1938–39. Japan also advanced her position as a purchaser of Indian exports, her share rising to 15.7 per cent in 1934–35. The share of the U.S.A. in Indian exports rose to about 12 per cent of the total in 1939–40.

The effect of the Second World War was to cause an eclipse of Germany and Japan in the Indian market and to bring up the United States as one of the major partners in India's external trade. Dividing the trading countries into four currency groups, the First Five-Year Plan estimated the shares of these groups in 1938–39 and 1948–49 as follows:[16]

	1938–39		*1948–49*	
	Exports	*Imports*	*Exports*	*Imports*
Sterling Area (excluding Pakistan)	53	58	48	47
Other Soft and Medium Currency countries	18	15	20	25
Dollar Area	12	7	28	24
Other Hard Currency countries (including Germany and Japan)	17	20	4	4

Within the Dollar Area the United States was responsible for supplying to India much larger amounts of mineral oils, metals, vehicles and machinery as compared with the pre-war years. In return, she absorbed larger amounts of Indian tea, spices, cashew nuts, manganese ore and jute manufactures. India's growing food deficit after the partition came to be met very largely from the food surplus available in the United States. In 1949–50 the relative shares of the U.K. and the U.S.A. in Indian foreign trade were

15. Jathar and Beri, Vol. II, p. 259.

16. Planning Commission, *First Five Year Plan*, p. 456.

32 and 17 per cent respectively in respect of imports and 25 and 15 per cent in respect of exports.

With the partition of India on the 14th August, 1947, the two parts of the sub-continent constituting the Indian Union and Pakistan began to export to each other goods which had so long figured as items of internal trade. During the period January–December 1950, India's receipts from Pakistan on merchandise account amounted to Rs. 31 crores and her payments on the same account were Rs. 33 crores.[17] Exports to Pakistan represented about 5.3 per cent of India's total exports and imports from Pakistan amounted to 6 per cent of India's total imports. Trade between India and Pakistan was greatly hampered by political differences, exchange rate instability and restrictions imposed by each country on the other's exports.[18]

Pattern of Foreign Trade Since 1951

Since 1950–51 the Indian Union has been in deficit on its commodity trade balance almost every year, despite the imposition of severe restrictions on non-essential imports and the adoption of several special measures for the promotion of exports. The import surplus has, however, served the twin purpose of meeting food shortages at home during the early years of planned development as well as providing essential raw materials and equipment for industrial development. The trade deficit has had to be made up by drawing on foreign exchange reserves and by borrowing from foreign governments and international institutions.

In 1950–51 nearly 40 per cent of India's total imports consisted of manufactured goods. Of this almost 66 per cent consisted of machinery and equipments. Imported fuel accounted for 8.5 per cent of total imports and imports of base metals were almost of the same value. Imports of cereals and cotton were valued at 27 per cent of total imports.

By 1979–80 liquid fuel and its derivatives had come to occupy a position of great importance in the list of imports, accounting by itself for almost 37 per cent of the total value of imports. Manufactured items accounted for about 54 per cent of total imports, but machinery and equipment formed only about 30 per cent of all manufactured imports. Imports of chemical fertilizers and manufactured iron and steel were on the increase, while imports of agricultural raw produce had declined in importance.

On the exports side India became dependent primarily on three export commodities, *viz.*, tea, manufactured jute products and cotton piecegoods, having lost her traditional exportable surplus in raw jute and cotton as a

17. Reserve Bank of India, *Report on Currency and Finance, 1951 52.*

18. For an account of government policy relating to import and export duties, see Chapter 16.

consequence of the partition. In 1950–51 the share of tea, jute goods and cotton piecegoods was almost 55 per cent of total exports. The share of other manufactured goods was no more than 15 per cent. The remaining export items were either raw (or semi-processed) primary produce or minerals.

At the end of the 1970s, in 1979–80, the share of tea, jute manufactures and cotton piecegoods had declined to only about 15 per cent. The share of other manufactured goods had risen to over 45 per cent. Exports of engineering goods exceeded in value the exports of cotton and jute manufactures combined. Exports of minerals and mineral fuels and lubricants showed some increase as a proportion of total exports.

In comparison with the rise in the value of the net national product, the value of exports had increased at a somewhat more rapid pace, specially after 1960–61. While exports constituted about 5 per cent of the net national product in 1960–61, their share in the N.N.P. rose to about 6.5 per cent in 1979–80.

Between 1950–51 and 1979–80 far-reaching changes had occurred in the direction of India's foreign trade. In 1950–51 the United Kingdom absorbed 23.3 per cent of Indian commodity exports and supplied 20.8 per cent of Indian imports. In 1979–80 these shares had declined to 7.8 and 8.3 per cent respectively. The United States of America purchased 19.3 and 12.5 per cent of Indian exports in these two years, while her share in Indian imports was 18.3 and 11.2 per cent respectively. The Soviet Union's share in our foreign trade, both exports and imports, was negligible in 1950–51. In 1979–80 she absorbed 9.9 per cent of Indian exports and provided 9.1 per cent of the country's imports. A few other countries with whom India's export trade has expanded since 1951 are. Australia. Egypt, France, West Germany. Indonesia, Italy, Netherlands, Sri Lanka and Japan. On the imports side, the countries that occupy a prominent position (after U.S.A., U.S.S.R. and U.K.) are: Japan, Canada, France, West Germany and the Middle-Eastern oil exporting countries like Iraq. Iran, Saudi Arabia. Kuwait and the United Arab Republic. In 1979–80 India ran an adverse balance of trade with a majority of her trade partners, but she had a surplus in her dealings with Japan, Bangladesh. Sri Lanka, Malaysia, Czechoslovakia and a few other countries.

Between 1960–61 and 1979–80 the size of India's trade deficit widened from Rs. 480 crores (3.6 per cent of N.N.P.) to Rs. 2563 crores (2.6 per cent of N.N.P.). It is clear that the trade deficit, though larger in Rupee terms, was less burdensome in 1979–80 than in 1960–61. During the decade of the 1970s exports from India increased (in value terms) at a rate of over 17 per cent per year, while imports increased at slightly over 20 per cent per year. As a consequence this decade witnessed a marked growth in the size of the trade deficit, not only in absolute terms, but also when considered in relation to the growth of the net national product.

15

Modernisation of Transport and Communications

In the early part of the nineteenth century India was very undeveloped in respect of road communications. The few trunk roads constructed under the Muslim administration of the country were falling into disrepair. Villages had traditionally remained isolated and few links of communication were there to connect them with one another. As W.P. Andrew has remarked, "when England became the dominant power in India. probably there never was a country with a people so rich and intelligent in which roads were so few and travel so difficult."[1]

A number of early roads constructed for the movement of British troops during periods of war were also allowed to fall into disuse when the temporary need was over. In fact, road construction for the purpose of ordinary communications and the facility of commerce did not receive much attention from the Company officials until 1836 when an improvement in postal communication was planned. As an initial measure in this direction a scheme for a Calcutta-Delhi road link was taken up at an estimated cost of £1.5 million. Calcutta and Bombay were connected by road in 1842. The road link between Bombay and Agra was completed at about the same time. These roads were planned as general social improvement measures or for strategic reasons. The idea that roads could play a vital part in exploring the country's interior for commercial purposes came into prominence somewhat later.

Village and local roads were generally the responsibility of the landlord in zamindari areas and of the ryots in temporarily settled areas. Regulations VII of 1822 and IX of 1833 provided for a cess of 1 % on all temporarily settled estates in order to form a Road Fund. In some areas ryots had to contribute their personal labour for the construction and repair of local roads. A proposal by the Government of Bengal to earmark the proceeds of Town duties for road building was thrown out by the Central Government. Shortage of funds thus prevented a rapid extension of the network of roads in the early years of British rule. Organisational defects also stood in the way. In Bengal the ultimate responsibility for road construc-

1 Andrew, W.P., *Indian Roadways*, as quoted in Banerjee, T.S., *Internal Market of India, 1834–1900*.

tion rested on the Military Board at Fort William. It had a number of other responsibilities in respect of army operations and could not pay sufficient attention to civilian road-building. In Bombay a Road and Tank Department was set up in 1835 to supervise all works relating to road construction, but its efficiency was so poor that very soon the responsibility had to be transferred to the Military Engineering Establishment. Madras had a Public Works Department working under the Board of Revenue. But the heterogeneous nature of the Board's duties prevented the members of the Board from paying more than a very casual attention to the problem of road construction. In 1846 roads were taken out of the Board of Revenue's charge and placed under a separate department headed by the Superintendent of Roads. But even this arrangement did not produce the desired results.

During Lord Dalhousie's tenure as the Governor-General of India Public Works Commissions, responsible for designing suitable plans for Civil Works, were instituted in all the three Presidencies. The Bengal and Madras Commissions, reporting in 1851 and 1852 respectively, suggested important organisational reforms. Acting on these suggestions and taking a cue from Captain Napier's experiments with Civil Works organisation in the newly annexed province of Punjab, Lord Dalhousie decided in 1854–55 to abolish the Military Boards and to set up Public Works Departments in the three Presidencies.

One of the several reforms tending to break down the barrier between local communities in different parts of India was the abolition of the Transit and Town duties. These duties, which were collected through the help of numerous internal customs check-posts, not only created enormous obstacles to the free movement of goods, but were a source of much confusion and corruption. Known as *sair*, they were one of the two important taxes under the Mughal system of revenue administration, the other being land revenue. Transit duties were levied at the check-posts on goods being moved from one part of the country to another, while Town duties were levied on many types of articles at the time of their entry into towns. The system often imposed a considerable burden, particularly when both raw materials and finished products had to pay duties at a fairly heavy rate. The rates were enhanced and the collection system was made more stringent after the East India Company took over the revenue administration of Bengal in 1765. In 1773 the duty was fixed at the uniform rate of 2½ per cent on all articles except salt, tobacco and betelnuts which were taxed under a different system. Under the administration of Lord Cornwallis the levy of internal customs was to a considerable extent abandoned. But customs houses were re-established in 1801 and the rates of duty enhanced to 3½ per cent. The internal customs system of the Bengal Presidency was reviewed by a Committee in 1808. On its recommendations Regulation IX of 1810 was adopted with the avowed purpose of consolidating the existing transit

duties. The new system, however, brought about "a frightful augmentation" of the burden of taxation and was responsible for a good deal of confusion regarding methods of collection.

The Town duties were less harmful than the Transit duties but since they were levied only in particular towns and not in others, they were discriminating in their incidence. They were also expensive to collect. Although only a small number of articles had to pay these duties, all articles entering and leaving the towns had to be scrutinised and for this a host of petty officials had to be employed. Even worse was the system, sometimes adopted, of farming out the Town duties to the highest bidder. Trade in many a town was disrupted as these revenue farmers attempted to exact the highest possible amount out of the trading community.

The system of inland duties in vogue at the time required every trader to maintain an elaborate organisation simply to cope with the customs formalities. This naturally put small traders at a disadvantage in comparison with the bigger and more resourceful merchants. Very often there was delay in completing customs formalities which involved the merchants in considerable losses. The officers in charge of customs outposts were apt to exercise their powers arbitrarily, thus adding to the harassment of the trading community. At the same time, a large amount of smuggled goods evaded taxation, the officers being won over by bribery. The revenues accruing to the State fell much short of expectation.

Although the evils of the system of internal customs were many, the Directors of the East India Company were not initially prepared to give up this source of taxation altogether but tried to bring about suitable reforms in the system. Some officials realised, however, that a system impeding the free movement of goods in the country could not last for long in an age of growing internal and international commerce. When Lord William Bentinck was the Governor-General of India, he appointed an official, Charles Trevelyan, to prepare a report on the working of the Transit and Town duties in Bengal. Trevelyan's famous "Report on Inland Customs and Town Duties in the Bengal Presidency," submitted in 1834, clearly brought out the evils of the system and played a very important part in the gradual abolition of these duties. The publication of the Report led to an outburst against the system which the Directors of the Company could not ignore.

Lord Bentinck also set up in 1834 a Commission of Civil Servants to examine and report on the Customs and Post Office system in India. In their first report, submitted in January 1836, the Commission agreed with Trevelyan's finding that internal duties were a great impediment to economic progress. They urged the abolition of the Transit and Town duties as early as possible. The Board of Customs, however, pleaded for the reform of the duties instead of their total abolition.

The death-knell of the system was sounded when Mr. Ross, Lieutenant-

Governor of Agra, took the initiative in abolishing a number of customs houses in that part of the country. The Court of Directors roundly condemned this action, but Ross defended his action on the ground that many of these customs establishments were costing the government more than the revenue which was collected through them. The initiative shown by Ross was followed by other officials whenever they felt that the revenue of the Company would not be very adversely affected in consequence of the reduction in the number of customs outposts. Faced with this action on the par of the officials, in Agra and elsewhere, the Governor of Bengal, Lord Auckland, decided to discontinue the system of inland customs in Bengal with effect from the 1st April, 1836. With the abolition of the Transit duties the Town duties also appeared indefensible; in many towns merchants began to register their protest against the continuance of the Town duties. On April 20, 1836, the Government of Bengal, by a notification, abolished the system of Town duties, the order taking effect from 1st May, 1836. The orders were later given final shape through Act XIV of 1836 adopted by the Governor-General in Council on the 30th May, 1836.

The burden of internal transit duties was comparatively light in Western India, although tolls used to be levied there also by almost every local authority. In Madras, in addition to the transit duty, a general duty of 5 per cent was levied on almost every important article of commerce. As this system depended for its operation on the services of a large number of petty officials, and gave rise to many public complaints, the Government of Madras decided in 1821 to rent out the right of collecting these duties. This reduced the cost of collection and led to an improvement in public revenues, but it is quite likely that under the new system the trading community was required to pay much more than what the Government treasury received. After 1836 when inland customs duties were being abolished in Eastern India it became necessary to enquire whether these could also be done away with in Madras and Bombay without undue sacrifice of revenue. So far as Bombay Presidency was concerned, the loss due to the abolition of transit duties could by made good by enhancing the level of taxation on maritime commerce. But the yield from inland customs in Madras was considerable and the loss involved in abolishing them could hardly be made good. Nevertheless, there was a powerful body of opinion which believed that the immediate loss of revenue could be compensated in course of time by the growth of trade which was being grievously shackled by the duties on domestic movement of goods.

Act I of 1838 abolished the Transit duties in Bombay Presidency, but left the Town duties unchanged. After a good deal of pressure brought to bear on the government by the trading community, the Town duties were completely abandoned in 1844. In the same year the Transit and Town duties of Madras Presidency were also abolished by Act No. VI of 1844. Thus began the process of fusion of markets which had so long been kept arti-

ficially aloof from one another and this paved the way for the capitalist expansion in the second half of the nineteenth century.

A History of Indian Railways

The first proposals for the construction of railways in India were made as early as 1832, only seven years after the opening of the first passenger-carrying railway line in England. During 1844-45 surveys were being carried out for the construction of railway lines in Eastern and South-western India. But it was not until August 1849 that the first contract was entered into between the East India Company and the Great Indian Peninsula Railway Company for an experimental railway line of 25 miles which was intended ultimately to connect Bombay port with the cotton-growing tracts of Berar and the country further east. The ceremony of first turning the sod of this railway line was performed on the last day of October 1850. On the 18th November, 1852, the first railway passenger train of India left Bombay for Thanā—a distance of 21 miles. This section of the railway was officially opened to traffic on the 16th April, 1853.[2]

Another contract, also entered into in 1849, had been made with the East Indian Railway Company for the construction of an experimental line from Calcutta which would ultimately run up to Rajmahal on the Ganges, about 200 miles north of Calcutta, with a branch going to the coalfields of Raniganj. The first segment of this line, from Howrah to Panduah, a distance of 38 miles, was opened to the public in July 1854. The official opening of the entire railway line from Howrah to Raniganj, a distance of about 120 miles, took place on the 3rd February, 1855.

The Madras Railway Company entered into its first contract in 1852. The Bombay Baroda and Central India Railway Company was also organised in the same year. Three years later, in 1855, the Sind Railway Company entered into a contract with the East India Company to construct a railway line from Karachi to the northern provinces. Altogether 12 railway companies entered the field between 1844 and 1860.

There were a number of reasons why the East India Company accepted the schemes of the railway companies that began to be floated by English merchants in the 1840s. Commercial considerations played an important part, specially the submission by the cotton traders and manufacturers in England who pointed out that transportation of cotton by cart over long distances was responsible for dirt getting mixed with the cotton. The Lancashire mills wanted good, clean cotton for their use and only railway transport could meet this need. The railways were also expected to open up the vast internal market of India to the British sellers of manufactured goods. Most of the early sponsors of railways in India believed that Indian

2. Lee-Warner, W., *Life of Lord Dalhousie*, Vol. II, 1904.

passengers would not take very kindly to the railroad. The railways were designed primarily for the carriage of goods. But the railways, it was realised, would facilitate the movement of troops and military stores as well. This important strategic consideration figured prominently in the despatches of both Lord Hardinge (1846) and his successor, Lord Dalhousie (1850, 1853). The views of these two Governors-General and the continuous pressure from such enthusiastic sponsors of railway companies as R.M. Stephenson of the East Indian Railway and John Chapman of the Great Indian Peninsula Railway ultimately led the Directors of the East India Company to agree to the proposals of the railway companies. The terms of agreement, in fact, permitted the companies to go ahead with railway construction with a guarantee of interest on their capital provided by the East India Company so that little risk was involved to the companies' shareholders in spite of the necessarily speculative character of this vast undertaking.[3]

By March 1856, when Lord Dalhousie left India, there were nearly 150 miles of railways open to traffic and another 150 miles under construction. It was the famous Minute of this Governor-General, despatched to the Court of Directors of the East India Company on 4th July, 1850, which ended the early hesitancy of the Company's Directors regarding the suitability of railways for India and cleared the way for future progress.[4]

The construction of railways was entrusted to private companies primarily on Lord Dalhousie's suggestion. He was aware of the limitations of Government agencies and suspicious of the tendency of officials to extravagance. But he did not at the same time want the companies to remain entirely outside Government control. In his Minute he wrote to the following effect on the subject of Government control over the railway companies:

"I trust that the East India Company will ever avoid the error of viewing railways merely as private undertakings, and will regard them as national works over which the Government may justly exercise, and is called upon to exercise, a stringent and salutary control. This control should not be an arbitrary right of interference, but a regulated authority, declared and defined by law, which is not to be needlessly or vexatiously excited; but which, in my humble judgement, is necessary at once for the interests of the State and the protection of the public."[5]

3. For an interesting account of the negotiations leading to the final agreements with the railway companies, see Thorner, D., *Investment in Empire* (Philadelphia, 1950).

4. In his Minute Lord Dalhousie wrote: "Not only is it practicable to construct railways as engineering works, but that such railways, when constructed, will, as commercial undertakings, afford a fair remunerative return on the money expended, so that the public may thereby be encouraged to invest their capital in similar works in other parts of India." (Quoted in Lee-Warner, *op. cit.*, p. 199.)

5. Quoted in *ibid.*, pp. 200–201.

In a second Minute on Railway construction, despatched in April 1853, Lord Dalhousie laid down certain general principles for railway development in India and also dwelt at some length on the advantages to be derived from the railways. He favoured the creation of a number of trunk routes linking up the principal port in each Presidency with its hinterland and connecting the different Presidencies with one another. Among the advantages to be derived he mentioned both the facilities to trade and commerce and the military advantage of a quick movement of troops from one area to another. This last advantage was reaped in abundant measure during the days of the Sepoy Mutiny in 1857–58.

The early contracts with the railway companies generally embodied the following features. First, the Government of India undertook to make land for railway construction available to the railway companies, under a ninety-nine-year lease, free of cost. Secondly, the companies were given a guarantee of interest on the capital which they invested, ranging between 4½ and 5 per cent per annum, as well as a guarantee against exchange losses, one rupee being always exchangeable for the companies at 1s. 10 d. Thirdly, it was stipulated that sums of money which the Government had paid out by way of fulfilling their guarantee relating to interest could be recovered by utilising the companies' surplus earnings in a subsequent year, but not more than 50 per cent of such surplus was to be utilised for this purpose. The remainder of the surplus belonged to the companies' shareholders. If no payment was due to the East India Company the entire surplus was to go to the railways' net earnings, limited to 10 per cent of the paid-up capital. Fourthly, the Government retained the option to buy up the lines from the companies after an interval of 25 or 50 years (but not during the period in-between). The prices to be paid to the companies were to be calculated on the basis of the value of the assets then prevailing. The railway companies were, however, free to make over their assets to the Government at any time by giving six months' notice. In case neither the Government of India nor the railways took any action in the meanwhile, the railways would automatically become the Government's property on the expiry of 99 years. No compensation would then be due for the line and buildings; only the rolling stock and equipments, if any, would have to be paid for. Lastly, certain general powers of supervision and control were to be exercised by the Government over the companies, but the companies retained full powers regarding their choice of staff. The phase of railway construction under the terms of contract just described endured for a period of about 25 years (1844–69) and is known in Indian economic history as the 'Old Guarantee System' of railway construction.

The Old Guarantee system was criticised as both unnecessary and wasteful. It was unnecessary in the sense that capital for the construction of railways would have been provided by British railway companies even without the special guarantee of the Government of India. It was wasteful

because the railway companies invested more capital in railway construction than was economically justified, being led to do so by the guarantee so generously provided by the Government. In operating the railway lines as well the Companies were under no inducement to curtail expenses. They had been assured that losses, if any, would be borne by the Government of India. The cost of railway construction per mile, which Lord Dalhousie originally estimated at £8,000, was actually nearer £18,000. This was much greater than the cost at which railways were constructed in England, Australia or Canada. The guaranteed interest on railways rose to nearly £3.9 million in 1868-69.[6]

In his Minutes of 1867 and 1869 the Viceroy and Governor-General, Lord Lawrence, suggested to the Secretary of State for India a system of direct government construction of railways. The Government of India, he urged, was financially in a sound position to be able to raise capital in the British market and undertake the construction of railways under its own supervision. He denounced the existing system under which the Government of India did not benefit at all from railway earnings, but was called upon to bear the losses. It was much more desirable, in his view, to operate the railways under direct State control so as to convert them into profit-yielding concerns. The Secretary of State accepted the Viceroy's proposals for direct government construction and, to save expenses, lines with a narrower gauge began to be constructed under this newly approved system.[7]

All railway lines constructed during 1870–79 were financed by State loans. The average rate of interest was about 4 per cent. The railway route mileage increased by over 4,000 miles during this period. The cost of construction per mile was definitely lower on the State lines, but the same could hardly be said about the cost of operations.

By the end of the 1870s the budgetary position of the Government of India had taken a serious turn for the worse owing to the fall in the exchange value of the Rupee and the costs of famine relief. It was becoming increasingly difficult to appropriate revenue surpluses for railways and borrowing in England was discouraged. At the same time the need for railway construction at a faster rate was being stressed as a measure of security against famines. The Famine Commission appointed to investigate into the causes of famines in several parts of the country during 1874–79 recommended the construction of at least 5,000 miles of railways as early as possible. The Government, finding itself unequal to the task, sought once again the assistance of private British companies.

6. Sen, S.K., *Studies in Economic Policy and Development of India, 1848-1926.*

7. By 1869, 4,255 miles of railways had been constructed with a total capital outlay of Rs. 89 crores. See Das, M.N., *Studies in the Economic and Social Development of Modern India, 1848–56*, p. 107.

The new system of railway construction was based on a sort of partnership between the Government and the railway companies. The Government contributed a part of the capital by direct borrowing but entered into agreement with the companies for the provision of the rest of the capital. The railway lines became from the beginning the property of the Secretary of State for India. The companies were guaranteed a certain interest, usually 3½ per cent, on the amount of capital which they helped to raise. They were responsible for working the lines and were remunerated by a 40 per cent share of the net profits. The interest of the companies could be bought off by the Secretary of State for India by paying them the amount initially subscribed. Such purchases were authorised under the terms of the agreement after the first 25 years and subsequently at 10-year intervals.

The system of railway construction by railway companies under the above-mentioned terms is known in Indian economic history as the 'New Guarantee System'. This system was more satisfactory than the Old Guarantee System in several respects. The interest guaranteed on the capital contributed by the companies was about 5 per cent under the old system, while under the new system it was only 3½ per cent. The old system left the Government with little opportunity to prevent over-capitalization in the railways, while the new system gave the Government the right of proprietorship from the very beginning. In case the Government wished to buy off the companies the old system required payment of compensation at the average market value of the companies' shares for three years preceding, while the new system provided for buying off the shares at their face value. The old system was rigid regarding the exchange rate at which rupee profits were to be converted into sterling. The new system transferred some of the exchange risks to the railway companies.

Meanwhile the purchase of some of the railway companies which had started operations during 1850–60 had fallen due. The Government's finances, however, did not permit purchasing the railways' shares at highly inflated prices. Accordingly steps were taken to modify the original terms of the contract which had provided that Government should only bear losses and not share in the profits. It was agreed that the State should appropriate 50 per cent of the net profits earned by the railways. This was, however, an unlikely prospect as the railways in most years did not earn an amount sufficient to release the Government from its guarantee obligations. For the first forty years of the Indian railways, the Government of India had to make payments of about Rs. 58 crores to the railway companies under the guarantee clauses.

For the first time the net earnings of railway companies exceeded the guaranteed interest in the closing year (1899-1900) of the nineteenth century. Since then the railways have generally been a source of revenue to the Government except in years of severe trade depression, for example, during 1929–36. In the early years of this century the accounts of the

railways often showed inadequate allowance for depreciation and maintenance and net earnings were thus exaggerated. There were also complaints against the excessively high freight rates maintained by some of the railways. It was frequently alleged that a policy of charging high rates was killing the traffic that would otherwise develop—in other words, the railway companies were sacrificing economic development prospects in their eagerness to maintain a high level of dividends.

There was another serious grievance against the structure of railway rates. The freight rates were so designed that raw materials destined for ports and consignments of manufactured goods originating at the ports paid a lower rate than similar goods travelling over the same distance between two places in the interior of the country. This policy was, of course, in the interest of the exporters and importers. But the development of new industrial centres in the interior was hampered by such a policy. All industries that had developed would, under this policy, tend to gravitate towards ports such as Bombay and Calcutta which were also the most important centres of foreign commerce in the country. This led to excessive congestion in these cities and contributed, in a number of ways, to increase the cost of production of manufactured goods in the country.

By the beginning of the present century India was equipped with about 25,000 miles of railways. However, owing to the different conditions under which railway lines had been constructed in the past, the railway administration was far from uniform. There were (*a*) State lines worked directly by State agencies, (*b*) State lines that continued to be worked by the companies even after take-over by the State, and (*c*) lines owned and operated by the companies. In addition, smaller railway lines under District Boards or the 'light' railway companies were also there. To evolve a coordinated policy of development for all these agencies, Lord Curzon's government appointed Mr. Thomas Robertson in 1901 to enquire into the working and administration of the Indian railways. He suggested that a Board of three Commissioners appointed by the Government should be set up to supervise the railway administration, while the day-to-day work should be left to the railway companies. Accordingly, the Railway Board was set up in 1905 as a separate unit in the Government of India's Ministry of Commerce and Industry. The Board consisted of three members including the Chairman and a Secretary. Its main task was to draw up the programme of expenditure on railway development by co-ordinating the proposals of the diverse agencies responsible for such development. In 1908 the status of the Railway Board was enhanced. The Chairman of the Board came to be recognised as a Secretary to the Government with direct access to the Governor-General.

Railway expansion was still believed to be too inadequate for a country of India's size. British trading interests began to exercise pressure on the Secretary of State to divert more funds for railway development. On the other hand, there was a powerful body of opinion in India which wanted

railway development to be halted for the time being and allocations for irrigation and education to be increased. To advise the Government of India on these issues the Secretary of State for India appointed a Committee under Sir James Mackay (later Lord Inchcape) in 1908. The Committee gave its opinion that the country could ultimately have even 100,000 miles of railway lines and recommended a substantial increase in the expenditure on railway development. They suggested an annual minimum of £12½ million as capital expenditure on the railways. The expenditure was gradually stepped up after 1909 and the railway mileage rose to over 34,600 in 1913–14.

During the First World War the services of the railways were under great strain. There was heavy movement of troops and stores from one region to another on railways, since coastal shipping traffic had to be cut down for shortage of shipping and greater risks at sea. Some 150 miles of railway track had to be dismantled and sent out for use in the Middle Eastern theatres of war. Lack of equipment and materials prevented proper maintenance of the existing tracks, while capital expenditure on railways had to be cut down for shortage of funds. The needs of trade and commerce were subordinated to military demand and the standard of service provided by the railways declined appreciably. The Indian Legislative Assembly generally put the blame for all this on the anti-national policy pursued by the British railway companies. There was persistent demand for State take-over of railway management in the case of lines that had already passed into State ownership and for accelerating the purchase of lines and assets from other railway companies. The contract with the East Indian Railway Company was falling due for renewal in 1924. This was made an occasion for claiming that the E.I.R.'s contract must be terminated and the lines placed under State management.

It was in this background that the Acworth Committee (under Sir William Acworth, a British railways expert) was set up in November 1920. Apart from seeking the Committee's opinion on the future system of railway management, the Government of India also referred to the Committee issues regarding the proper sphere of action of the Railway Board and the organisation of railway finance. It was being felt that the Railway Board, as constituted, could not exercise sufficient control over the companies managing the railways as it had never been provided with an adequate technical and inspection staff. As regards railway finance, the railways were unable to develop their own system of accounting, appropriate to commercial undertakings, as long as railway finance remained a part of the general budget of the Government of India.

The majority report of the Acworth Committee recommended a system of State management for Indian railways.[8] Although management by com-

8. By 1924 nearly 60 per cent of the railway mileage in India had passed under State management.

panies was generally regarded as more flexible and more economical, in India companies were not in most cases managing their own property but property that had already passed into State ownership and consequently company management in India could not always display the virtues that were claimed for it. The State was already exercising a good deal of control over the railway administration even where nominal management remained with the companies. Such a system of dual administration, the Committee felt, should be ended and the State should take the entire responsibility for the management of the railways.

State management was favoured by public opinion in India. The Committee pointed out that even if the railways were managed by companies formed with Indian, instead of British, shareholders, the backing of the State would have to be sought to raise finance for railway expansion and State intervention in the companies' affairs was bound to continue. On the other hand, the Committee argued, a system of direct State management could be expected to create greater enthusiasm among the people and lead them to subscribe more readily to railway loans. Moreover, the share of the profits going to the railway companies would also accrue to the State instead of being remitted to England and this could be used to accelerate the work of replacement and new construction in the Indian railway system. National interests were also likely to be served to a larger extent under State management than under company management. It was realised that the grievances of the trade and the travelling public were likely to be redressed more promptly if the highest railway authorities functioned in India and not in England, as was the case with the foreign-owned railway companies. The Directors of the foreign railway companies could not in the nature of the case realise local problems and often adopted measures which offended the Indian commercial interests and the public.

The Acworth Committee also suggested a number of measures to improve the working of the Railway Board. The membership was enlarged. The Railway Board came to consist of 5 members, viz., the Chief Commissioner, the Financial Commissioner, a member in charge of general administration, a second member for technical administration and a third one for labour matters. The Board was given additional powers to exercise effective control over the railway administration. Central and Local Advisory Councils were recommended to be set up with representatives of the trading community and the travelling public. A Railway Rates Tribunal was to be set up to control railway fares and freights after hearing representations from the railways and their users.

The Acworth Committee also came out with the recommendation that the railway budget should be presented separately instead of being included in the Government of India's general budget. This was necessary in the interests of railway development and improvement of railway facilities, since the railway surplus could then be earmarked for these two purposes.

This recommendation was given effect to in 1924 when the Indian Legislative Assembly adopted the Railways Separation Convention. The 'Convention' laid down that the railways would contribute every year to the general Exchequer a sum equal to 1 per cent of the capital-at-charge in the previous year plus one-fifth of any surplus profit. Moreover, if the amount to be transferred to the railway reserve exceeded Rs. 3 crores, one-third of that excess would again be credited to the Exchequer. Under the terms of this convention the Government of India received from the railways' surplus earnings of about Rs. 42 crores during 1924–25 to 1929–30. The first separate railway budget was presented to the Indian legislature in 1925.

During the years of the Great Depression the earnings of railways fell sharply. The bulk of the freight carried on Indian railways consisted of agricultural raw materials destined for export. As the world demand for India's exports shrank, the railways' services fell in demand. The railways also began to face at about the same time increasing competition from road transport.[9] Owing to reduced earnings the railways were unable to contribute anything to the general revenues of the Government of India after 1931–32. Although earnings recovered after 1936-37 they were not large enough to enable the railways to clear up their accumulated arrears which, under the terms of the 1924 convention, they were required to do. By a resolution adopted in 1937 the Government permitted the discharge of accumulated liabilities to be deferred for a few years. As a result the railways' contribution to the general revenues could be resumed in 1937. During the depression years the railways had also been forced to deplete their 'depreciation fund' in order to meet the obligation of interest payments.

The financial position of the Indian railways during the 1930s brought forth various criticisms against the railway administration. The Indian Legislative Assembly took up the issue in 1936 and recommended a thorough-going enquiry into all aspects of railway finance. A committee of three railway experts, under the chairmanship of Sir Ralph Wedgwood, was set up in October 1936 and submitted its report in June 1937. The Committee stressed the importance of an adequate 'depreciation fund' for the railways and suggested the setting up of a special 'equalisation fund' for the payment of interest and amortization charges. The Committee's proposal that railways' contributions to general revenues should remain suspended until the railways were out of the woods did not, however, find acceptance with the Indian legislators. Under the Niemeyer Award (see Chapter 19) the Central Government's contribution to Provincial finances was linked up with the railways' contribution to general revenues. The

9. Other causes of reduced railway earnings during this period were: civil commotion in the early 1930s, floods and earthquakes, rise in wages of railway workers, and lower imports due to tariff policy adopted in India.

Provinces, accordingly, clamoured for maintaining the railways' contribution to general revenues intact even if this implied a deterioration in the standards of maintenance of the railways.

The Wedgwood Committee also pointed out that, owing to the growing competition from road transport, the railways were losing about Rs. 4.25 crores in revenues per year. At the same time the road services were developing in a haphazard manner and would fail to provide trustworthy service to their users. To avoid railway losses and to provide better road services an effective policy of rail-road coordination was evidently required. With this end in view the Committee recommended a system of comprehensive licensing and regulations of road transport operators by Provincial governments, but insisted that such regulation must pursue a uniform policy laid down by the Central government. The critics of the Committee were of the opinion that the regulation measures which it recommended were designed to protect the railways' interests at the expense of road transport operators. This was stoutly denied by the Committee who pointed out that a policy of regulated development would serve the interest of the road transport operators themselves. To ensure effective coordination of rail and road services the Committee favoured participation in road transport by the railways.

The Second World War helped the railways increase their earnings. But the traffic increased to such an extent[10] that railway lines and rolling stock had to be over-worked. Without a domestic industry supplying the railways' rolling stock and stores requirements, adequate replacement was not possible during the years the war lasted. Moreover, as in the First World War, some railway capacity had to be bodily removed to the Middle East to help in the prosecution of war in that region. A part of the capacity of the railway workshops in India was also diverted to the manufacture of munitions. For all these reasons the railways emerged out of the War with a huge back-log of renewals and replacements.

The partition in 1947 added further to the problems of the railways. Some of the existing railway units in the north-western and eastern regions of the country had to be divided up and new workshop facilities had to be developed for the portion of the railways included in the Indian Union. With the Karachi port lost to the country, new terminal facilities had to be developed in Bombay, a major port had to be created at Kandla and new connecting links had to be built up.

By the end of 1949–50 the railways, it was estimated, were in urgent need of a renewal programme for 1,050 locomotives, 5,514 coaching vehicles and 21,418 wagons, the normal annual renewal figures being 190,650

10. Between 1938-39 and 1950–51 passenger-miles on class I railways increased from 17,780 million to 39,720 million. During the same period freight ton-miles increased from 21,786 million to 26,581 million. (Government of India, *First Five-Year Plan*, p. 463).

and 5,000 respectively. The First Five-Year Plan for the railways had simply to be a plan for rehabilitation rather than for development. At the same time, it was essential that additional capacity in the railways had to be built up if other major projects of development were not to be held up due to a transport bottleneck.

Roads and Road Transport

It was Lord Dalhousie who gave the initial impetus to the construction of new roads, but the development of railways later in the nineteenth century created the demand for more roads as feeders to the railways. Although the construction of roads at right angles to the railways was thus encouraged, the interests of the railways worked against the construction of roads parallel to the railways and this hampered the development of big trunk roads. Local authorities, endowed with a new life by the reforms introduced by Lord Mayo and Lord Ripon, tried, within the limits of their funds, to build local roads and convert some of the *Kutcha* (un-metalled) roads into *pucca* (macadamised) thoroughfares. By 1936-37 India, excluding the Princely States, had over 3 lakh miles of roads of which nearly 85 per cent was maintained by the various local authorities such as district boards, local boards and municipalities. The mileage of metalled roads was only about 25 per cent of the total. Many of the so-called un-metalled roads were little better than tracks and were liable to become unusable during the rains.

The Royal Commission on Agriculture had pointed out in 1928 the unsatisfactory state of road development in India and the problems which this created for the orderly marketing of agricultural crops. India at that time possessed no more than 20 miles of roads for each 100 sq. miles of area, whereas in the U.S.A. there were 80 miles of roads for the same area. Apart from the inadequate road mileage, there were the problems of under-maintenance, due mainly to the poor finances of the local authorities, and the unsuitability of many of the roads for motorised transport. In the inter-war period the use of motor trucks and other motor vehicles was spreading, but road development was lagging behind. Even in those regions of the country where railway transport was too uneconomic or inconvenient, road transport could not play the role expected of it owing to inadequate investment on roads. At the same time, there were regions where roads and railways competed with each other for the limited cargo available.

In the circumstances the importance of a scheme of coordination between rail and road transport could not be overlooked and in 1932 the Government of India appointed a two-member Committee consisting of Mr. K.G. Mitchell, Road Engineer to the Government and Mr. L.H. Kirkness, Special Officer with the Railway Board, to enquire into the matter and make recommendations. The Mitchell-Kirkness Report (1933) recommended the creation of a set of coordinating authorities throughout India.

The hasty expansion of motor transport was roundly condemned and the necessity for putting a curb on the motor transport operators was emphasised. The Road-Rail Conference which met in Simla in April 1933 considered the Mitchell-Kirkness Report and recommended a policy of authorising railways to own and operate a fleet of road vehicles. This was done by amending the Railways Act in September 1933. Another approach to the rail-road coordination problem was to set up in 1933 a Transport Advisory Council entrusted with the function of evolving a road policy on an all-India basis, keeping in mind the relation between roads, railways and other forms of transport. An important step was taken in 1937 with the establishment of a Department of Communications in the Government of India which was to look after all forms of communication in a coordinated manner and included roads, railways, inland navigation and civil aviation on the one hand and posts and telegraphs, broadcasting and meteorology on the other.

The Motor Vehicles Act, adopted in 1939, had as one of its objectives the regulation of road transport operators. Regional transport authorities set up under this Act were enjoined to grant permits to motor transport vehicles only after satisfying themselves that uneconomic competition was not thereby encouraged. The transport authorities were also given other powers to secure the safety and convenience of passengers using road transport.

The construction of roads has been handicapped in India, as compared to the expansion of railways, primarily because the former was built from the government's (or local authorities') current budgetary resources, while the latter was built with borrowed funds. The Road Development Committee of 1927, when faced with the problem of raising adequate resources for road-building, could not come out boldly in favour of the method of loan finance. Instead it suggested a policy of special duties on motor spirit which were imposed in 1929. The Finance Act of that year increased the duties on both imports and domestic production of motor spirit from 4 annas to 6 annas per gallon.[11] The proceeds from these enhanced duties were to be credited to a special Road Development Account. The amount credited to this Account was to be distributed among the Provinces as follows: after deducting 10 per cent for Central use, the bulk of the remainder was to be allocated to each Province in proportion to the amount of petrol consumed there in the previous calendar year and another portion was to be allotted to the Government of India for making grants to the minor Provinces and Princely States. The grants were to be made on the advice of a Standing Committee for Roads set up at the Centre each year with members of both houses of the Indian Legislature. This arrangement, known as the Road Convention, was approved by the Indian Legislature in 1930. In 1934 the share of the Central Government in the Road Develop-

11. 1 anna = 6.25 paise.

ment Account was raised to 15 per cent and provision was made for expenditure out of this fund on road maintenance as well as for servicing of loans incurred for road development. In a Resolution of 1937 the Central Government was authorised to retain for an indefinite period a Province's share in the Road Fund if delays without reasonable cause were found to occur in the utilisation of the funds. The Centre could also use the funds as a lever to pressurise Provinces to bring their motor transport regulations into line with the all-India policy. The financial scheme which Sir Otto Niemeyer drew up after the passing of the Government of India Act, 1935 (see Chapter 19), made the Provinces' share in income tax proceeds dependent on railway earnings; this was an indirect pressure on the Provinces to regulate the development of motorised road transport so that railway earnings might not suffer as a consequence.

During the Second World War some roads of strategic importance were constructed under the supervision of military engineers. In December 1943 a plan for future road development in the country was discussed at a conference of the Chief Engineers of all the Provinces at Nagpur. This 'Nagpur Plan' aimed at bringing all villages in India within five miles of a main road and estimated that this could be done by adopting a programme of 4 lakh additional miles of road development, phasing the programme over ten years. The cost in 1943 prices was calculated as Rs. 372 crores. The roads to be developed were classified as (*a*) National Highways to be built and maintained by the Centre, (*b*) Provincial (later State) Highways for which the responsibility would rest on the Provinces, (*c*) District roads to be maintained by district boards, and (*d*) village roads to be looked after by village self-governing agencies. By 1946 road development plans had been drawn up in many Provinces while the Central Government assumed responsibility for the development of National Highways in 1947. A Road Transport Corporation Act was adopted by the Central Legislature in 1948 and revised in 1950 to enable Provincial governments to set up statutory corporations for the regulation of road transport systems in their territories.

Between 1947 and 1950 an expenditure of Rs. 27.1 crores had been incurred in the Provinces for their programmes of road development; at the prices then prevailing this represented barely 5 per cent of the target under the Nagpur Plan. Financial difficulties as well as physical shortages of construction materials and skilled labour stood in the way of a more rapid pace of development. The Central Government's expenditure on National Highways for the period 1947–52 amounted to Rs. 9.3 crores or 15.5 per cent of the recommended target.[12] The Central road programmes envisaged the development of 13,400 miles of roadways, while the States were expected to add about 30,000 miles in all. At the beginning of the First Five-Year

12. *First Five-Year Plan*, p. 479.

Plan period (1951–56) India had over 97,500 miles of surfaced roads and about 151,000 miles of unmetalled roads.[13]

The entry of commercial transport operators using motor transport is traceable to the years immediately following the First World War. Surplus vehicles left by the military establishments were utilised in the first instance, but the rise in imports of motor vehicles was thereafter quite rapid. In 1950 there were altogether over 47,500 transport operators of whom more than 46,000 were small operators having a fleet of five or fewer vehicles. State transport services had also entered the field and their organisation was becoming wider in the post-Independence period. By June 1950 the capital at charge in the various State transport organisations had reached a figure of Rs. 12 crores. In some States transport undertakings had been organised on the basis of joint participation by the State Government and the railways, while in others private operators were also included in such joint undertakings.

Several proposals for the manufacture of automobiles in India were considered in the period immediately preceding the Second World War and the one for an automobile plant at Matunga, Bombay, was in an advanced stage of implementation when the War intervened. It was only in the post-war period that automobile manufacturing capacity came into existence. But actual production of automobiles in 1950–51 was still below 5,000. The automobile industry was granted protection in advance of actual production, one condition on which protection was given being that it must reduce its dependence on imported components progressively over the years.

Sea and River Navigation

Only six years after the first steamship sailed between England and the U.S.A. some enterprising merchants in England and India combined to build and run the first steamer from England to India. The ship called the *Enterprise* sailed from Southampton to Calcutta round the Cape of Good Hope in 1825. But the route was too circuitous, the time taken too long and the costs of operation too large to leave any scope for profit. Merchants in Bombay and Calcutta frantically tried to develop alternative routes, two routes suggested in this connection being (*a*) an 'overland' route using a land strip near the Red Sea where transhipment was to be done, and (*b*) a river route using the river Euphrates and the Persian Gulf. The Bombay merchants who advocated the former route even got a ship, the *Hugh Lindsay*, on this route in 1829, but the experiment proved too costly. The Calcutta merchants stoutly opposed the 'overland' route because it was to terminate at Bombay and would leave Calcutta without

13. *Review of the First Five-Year Plan*, 1957, p. 235.

direct connection with the 'home' country. They also attempted to bring the Persian Gulf route into use during 1835-37 but with little success. The East India Company was at first not very keen on introducing steamships in the India-U.K. route, but agreed under pressure in 1835 to add two ships to the Indian Navy for the Bombay-Suez run. The British Parliament set up Committees in 1834 and 1837 to discuss the best way of introducing a regular steamer service between England and India. While both London and Calcutta merchants submitted their pet schemes for the consideration of these Committees, the ultimate solution to the problem was found in 1840 by entering into a long-term agreement with the Peninsular and Oriental Steam Navigation Company to carry mail and passengers to India.[14]

After the removal of restrictions on the carrying of goods in non-British ships a number of other steamship lines also entered the Indian Ocean, but British shipping companies remained the major carriers of Indian cargo throughout the British period. They also established a near-monopoly in the port-to-port traffic in India. Prospective investors in 'coastal' shipping were scared away by unfair rate wars and a host of other underhand devices. In 1938-39 the percentage distribution of vessels clearing at Indian ports was: British 66.6, other foreign 29.3, Indian 3.4 and indigenous crafts 0.7.[15] As regards coastal traffic the share of Indian companies during the five years 1933-34 to 1938-39 was only about 28 per cent.

The Indian Legislature considered in 1928 a non-official bill moved by Mr. S.N. Haji of the Scindia Steam Navigation Company authorising the Government of India to reserve the coastal traffic in India for those companies at least 75 per cent of whose shares were owned by Indian nationals. The reservation was to be introduced gradually over a period of five years. Although this policy smacked of discrimination against foreigners, it followed a practice current in most other countries. But the British authorities in India were reluctant to recognise this right for India and branded this issue as one involving discrimination between British and Indian subjects of the Empire and as such a matter for the Constitutional experts. In fact the issue was discussed at the Round Table Conference on Indian Constitutional Reforms in 1931 and as a sequel the Government of India Act of 1935 provided specifically for non-discrimination against British commercial interests. It was only after independence, in 1950, that measures for reservation of 'coastal' shipping to Indian companies could be introduced.

The dangers of depending on foreign shipping lines for carrying the articles entering the country's foreign trade became very clear during the First World War. For the lack of a merchant navy the country had to suffer from an acute shortage of imports and could not sell her exports in markets where profitable trading opportunities existed. A merchant navy

14. For a fuller account see Thorner, D., *op. cit.*, Ch. 2.
15. Jathar, G.B. and Beri, S.G., *op. cit.*, Vol. 2, p. 215.

could also be useful as an auxiliary to the naval defence forces as England's experience during the War had abundantly proved. Public agitation for a merchant navy led the Government of India in 1923 to appoint a Mercantile Marine Committee. The Committee made a number of useful recommendations for the development of a mercantile marine fleet in India including the grant of bounties for the construction of ships in suitable ship-building yards in India, the grant of mail-carrying contracts to Indian shippers and the expansion of facilities for the training of officers and men of the navy. The reservation of 'coastal' traffic to shipping companies with a majority of Indian shareholders was suggested by this Committee as one method of encouraging the growth of a mercantile marine in India. Most of this Committee's recommendations went unheeded; the only important step taken was to re-equip the steamship *Dufferin* as a training ship for Indian naval cadets. As a result India entered the era of Independence with only about 1 lakh tons of gross registered tonnage, taking into account some tonnage (about 25,000) lost during the Second World War

A ship-building yard was started at Vishakhapattanam during the war years; the immediate purpose was to provide repair facilities for ships. After the war ended this shipyard came to be utilised for ship-building and the first India-built passenger ship, the *Jala-Usha*, was launched from this yard in 1948. By 1950 the gross registered tonnage owned by Indian shipping companies rose to over 3.6 lakhs, although the Shipping Policy Committee (1947) had recommended a target of 20 lakh tons to be attained in the next five to seven years. The tonnage used for coastal shipping was about 1.7 lakhs which was too small to make the policy of reservation of coastal traffic fully effective.[16] The tonnage used for overseas trade was also very small, being about 2.2 lakh tons, the average capacity of a ship in the overseas routes being only 3,000 tons.

Shortly after Independence the Government of India accepted in principle a policy of establishing three Shipping Corporations in collaboration with private industry. Following this policy the Government set up the first Shipping Corporation in March 1950, subscribing 74 per cent of the capital while the remaining 26 per cent was taken up by the Scindia Steam Navigation Company which was appointed as the Managing Agents of this Corporation. The Government of India was also providing loans to shipping companies on special concessional terms to acquire additional tonnage for use in coastal as well as overseas sea-routes.

While the steamship was thus coming into its own, sailing vessels continued to ply in coastal waters and were expected to remain in use for many more years. According to the Sailing Vessels Committee (1949) about 2,600 such vessels with a gross tonnage of 1.5 lakh tons were engaged in

16. The proportion of coastal traffic carried in Indian-owned ships rose to 62 per cent in 1949.

India's coastal trade. Nearly 40,000 men were engaged in this form of sea navigation in that particular year. It was estimated that these vessels carried a cargo of 1-1.5 million tons, every year and were a useful supplement to steamer transport.

The use of steam vessels in river navigation is supposed to have started in India in 1823 when a service was started from Kulpi to Calcutta.[17] In 1842 a regular steamer service was set up between Calcutta and Agra. But as the railways claimed the whole attention of the administration, in later years the use of navigable waterways came to be relatively neglected. In 1872 Sir Arthur Cotton, the great engineer who built a number of irrigation canals in South India in the late nineteenth century, proposed to a committee of the British Parliament that irrigation and navigation facilities should be combined in the construction of canals and submitted a scheme costing about Rs. 45 crores. Water carriage, he contended, would be less expensive than railway transport. But the opposition of the railway companies and the heavy initial cost of the scheme prevented its realisation. As the railways began to earn profits towards the close of the last century proposals for the development of navigable rivers were allowed to die a quiet death.

Yet there were many parts of the country where inland waterways could prove useful as supplements to the railways. It was estimated a few years back that about 5,000 miles of river routes in the country could be made navigable by modern power craft.[18] Only about one-third of it was being actually used.

Air Transport

The development of air transport in India started in the post-World War I period, but the first regular airline service did not begin to function until 1932. The earliest use of air-borne craft for civilian purposes was for the transport of mail between Bombay and Karachi.

By 1939 three Indian companies had been organised to operate air services, a few international airlines had started using India on their regular route-flights and the Government of India had introduced a scheme of subsidies to flying clubs in the country with a view to reducing the cost of training of civilian aircraft operators. It was, however, the Second World War which made aviation one of the major forms of transport in India. In 1949 there were 12 companies operating inland air services. A year earlier the Air India International, a Government-*cum*-private enterprise, had been set up to operate on overseas routes. The share of the Government in this company was 49 per cent with an option of acquiring a further 2 per cent.

17. Banerjee, P.N., *A Study of Indian Economics*, p. 441.
18. *Review of the First Five-Year Plan*, 1957, p. 242.

Further, the Government had invested about Rs. 10 crores up to 1950-51 for the provision of aerodromes, maintenance of training organisations such as the Civil Aviation Training Centre at Allahabad and the installation of radio aids for air navigation. The control of the government over the private air transport companies was exercised through the Air Transport Licensing Board set up in 1949. An Air Transport Enquiry Committee which investigated the conditions of the transport companies disclosed that some of the companies were in poor shape owing to excessive competition for a limited amount of business and recommended a number of steps for consolidation of the companies. Two other ways in which the Government began to assist the air transport companies in the post-independence period were (*a*) the introduction of an All-Up Air Mail Scheme under which all first-class internal mails were carried by air wherever air link was available, and (*b*) the grant (in 1949) of financial assistance to all air companies, flying clubs and other air operators at the rate of 9 annas per gallon of their petrol consumption.

Scheduled air services carried nearly 3.6 lakh passengers in 1949 and were responsible for flying a cargo weighing 13.3 million lbs. In addition there were non-scheduled services mostly for cargo flights.

Communications

Although a system of postal communications had been introduced in India even before the Mughals and was continued under the East India Company, the present system of uniform postage throughout the country and the payment for postal services through stamps instead of in cash was the creation of Lord Dalhousie. In one of his Minutes dated 28th February, 1856, the Governor-General described these changes as "a departmental revolution.. having consequences so widespread and so generally beneficial"[19] The significance of a cheap means of all-India communication for the expansion of commerce and industry can hardly be over-rated.

The electric telegraph also made its appearance in India during Dalhousie's regime. The value of this rapid means of communication from the strategic point of view was quickly appreciated and Dr. W. O 'Shaughnessy was appointed to submit a report on the possibility of the electric telegraph in India. On the basis of his Report (1852) the sanction of the Directors of the East India Company was obtained and in 1853 the telegraph line between Calcutta and Agra was installed. On the 2nd March, 1854, a message was sent over this line from Agra to Calcutta, a distance of 800 miles. By 1855 about 4,000 miles of telegraph lines had been laid out.

The development of postal, telegraphic and telephone facilities, however, proceeded at a rather slow pace. As late as 1950-51 there was only

19. Quoted in Ramsay Muir, *The Making of British India*, p. 367.

one Post Office for 10,000 people, the rural areas faring worse in respect of postal facilities. The number of Telegraph Offices was less than a quarter of that of Post Offices, while telephones were so few that barely 0.2 per cent of the population could be provided with a telephone. The Posts and Telegraphs Department's post-Independence plans included the setting up of Post Offices in every village with a population of 2,000 or over as well as an expansion in telegraphic and other telecommunications facilities.

The radio as a means of communication came into use in the 1930s. Up to 1935 there were only two 1.5 kw. transmitters in the State Broadcasting Service, but the situation improved in the late 'thirties and during the Second World War. After partition the Indian Union retained 6 medium-wave and 5 short-wave transmitters with a coverage of about 3.26 crores of listening population. The post-Independence development up to the time of the First Five-Year Plan Report (middle of 1952) was comparatively rapid. By that time 30 medium-wave and 14 short-wave transmitters had started functioning: they catered to a listening population of nearly 8 crores.

Transport Development Since 1951

In 1950–51 the Indian Union had over 34,000 miles (54,845 kilometres) of railway track. The railways carried in that year 130.8 crore passengers, the average distance travelled by a passenger being about 52 kilometres (thus indicating the preponderance of suburban traffic). The average distance over which 94 million tonnes of railway freight was carried in that year was about 474 kilometres. The net earnings of the railways, after meeting working expenses, amounted to Rs. 47.56 crores. Out of this Rs. 32.51 crores was transferred to general revenues.

In the initial years of planned development, the bulk of the expenditure on the railways had to be on the replacement of rolling-stock worn out during the Second World War. The laying down of new railway lines received a low priority. Subsequently the emphasis shifted to dieselisation and electrification schemes to speed up movement. As a result only about 7,200 kms. of railway lines have been added to the previously laid down track over the period of the first five Plans (1950-51 to 1978-79). The average distance travelled by passengers has remained practically unchanged, but the number of passengers went up almost three-fold. In contrast, the distance over which railway freight had to be transported increased to almost 700 kilometres and the weight of freight carried in 1977–78 was 237.3 million tonnes. The net earnings of the railways went up to about Rs. 360 crores in 1977-78.

The railways have gradually improved their capacity for indigenous production of equipment and rolling stock. In 1950–51 the railways were

importing 23.6 per cent of their equipment and stores; by 1980–81 such imports came down to 9.6 per cent.[20]

One of the problems facing the railways in recent years is the sharp increase in their working expenses. Between 1950–51 and 1979–80, the railways' gross traffic receipts went up by 789 per cent, but their working expenses mounted by 918 per cent.

For administrative convenience the Indian railways have been divided into nine zones, each under a General Manager who is responsible to the Railway Board. For the manufacture of locomotives, coaches and wagons, the railways depend largely on their own workshops, although some orders are also placed with private engineering concerns. The yearly production of locomotives of all types increased from 179 in 1955–56 (starting with only 7 in 1950–51) to 205 in 1977-78. The highest annual production of wagons recorded was in 1965-66 when over 23,500 wagons were built. The total number of locomotives, coaches and wagons in service at the end of the Fifth Plan (1974–79) was 11.152, 37,564 and 402,000 respectively.

Under the Railways Convention of 1950, the railways are required to pay to the general revenues at the rate of 4 per cent of the capital-at-charge. A Parliamentary Railway Convention Committee reviews, once in five years, the financial arrangements between the railways and the Government of India. This committee studies the financial position of the railways, including provisions for depreciation of assets. The provisions for expansion of the railway network are also looked into by this Committee. However, the needs for general economic development have forced upon the country a situation in which railway expansion has to remain limited, while the contribution of the railways to general revenues has gone up by successive steps to 6 per cent of the capital-at-charge (on capital invested after 1st April, 1980 the contribution is at 6.5 per cent).

As regards road development, the years since 1951 have witnessed fairly rapid progress. Between 1950–51 and 1978-79 the length of 'surfaced' roads went up by 62902 kilometres, while unsurfaced (but motorable) roads went up by almost 9 lakh kilometres. The degree of utilisation of roads also increased, as is evident from the increase in the number of registered motor vehicles from 3 lakhs to 33 lakhs during this period.

Road development is one of the programmes utilised for the employment of surplus rural manpower. The basic objective behind road construction in rural areas is to connect all villages in the country, with a population of 1500 and above with a network of all-weather roads.

Passenger transport by buses is being provided by public sector transport undertakings predominantly, if not exclusively. Goods transport, however, is handled almost wholly by private carriers. To facilitate inter-State movement of goods, a scheme of national permits for carriers was introduced in 1975. However, the number of national permits to be issued

20. Government of India; *India: A Reference Annual*, 1982 issue.

was subject to central regulations. The majority of carriers operated on the basis of State permits or Zonal permits issued on the basis of agreement among a number of States. For the coordination of road services on inter-State routes, an Inter-State Transport Commission was set up in 1958.

Road transport being faster and more convenient, the rapid development of roads and trucking services poses a threat to the earnings of railways and measures for coordinated development of the two forms of transport becomes absolutely essential. A Committee on Transport Policy and Coordination was set up in 1959 to lay down principles of coordinated development for roads and railways.

The competition offered by road transport operators to the railways will be evident from the following statistics. In 1950–51 the shares of passenger traffic and goods traffic handled by mechanised road transport were 26 per cent and 11 per cent respectively. By 1977–78 these shares had gone up to 59 and 32 per cent. It was also estimated that 55.5 per cent of mechanised passenger road transport vehicles were in the public sector.[21]

The development of shipping has been quite remarkable after Independence. From 36 ships with a Gross Registered Tonnage of 2.6 lakh tonnes in 1956, India's overseas fleet expanded in 1980 to 319 ships with a GRT of 52.9 lakh tonnes.[22] As a result the share of Indian ocean-going ships in the total overseas trade of the country rose to 30.5 per cent by the end of the 1970s. In coastal shipping, however, the tonnage engaged has remained more or less stagnant, although enough scope for expansion remains. Four ship-building yards have come up since Independence, all of them in the public sector.

Use of rivers and canals by mechanised crafts for transport of goods and passengers has remained rather limited, despite the advantages offered by this mode of transport in respect of energy consumption. Except in parts of Eastern and Southern India (Assam and Kerala), the development of inland waterways for transport purposes remains stunted. The Inland Water Transport Committee (1959) outlined a set of development programmes, but lack of adequate financial and organisational support has slowed down the implementation of these programmes.

The progress in civilian air transport has been commendably fast. Passenger traffic in Indian domestic flights went up from 6140 lakh passenger kilometres in 1960–61 to 42290 lakhs in 1979-80.[23] The domestic air services provided in 1980 almost seven times as many seat facilities as in 1960. The International flight services, operated by the publicly owned concern. Air India, had increased seat facilities almost eight-fold during the same period.

21. Planning Commission, *Sixth Five Year Plan*, 1980–85, p. 303.
22. *Ibid.*, p. 306. About 55 per cent of total GRT belonged to the public sector.
23. Planning Commission, *Sixth Five Year Plan*, p. 307.

Development in Communications Since 1951

Since the inception of the Five Year Plans in 1951–52 the number of post offices and telegraph offices has steadily increased. Between 1950–51 and 1980–81 the number of post offices in urban areas went up from 5284 to 14535; in rural areas the corresponding increase was from 30,810 to 1,24,689. The usual norm is to have a post office within 3 kilometres from every rural settlement, but at least 10 per cent of the cost of the post office should be covered by the revenues earned. In 1981 more than 8.5 lakh employees served the Posts and Telegraphs Board which administers the postal services.

The number of telephone exchanges in the country rose between 1951 and 1981 from 540 to 7,893. The number of telephones went up somewhat faster, from 1.68 lakhs to 28.32 lakhs. The Indian Telephone Industries, a public sector undertaking set up in 1948, has made the country nearly self-sufficient in telephone equipment and has some spare capacity for exports. Yet in relation to the size of the population, and even in relation to the number of would-be subscribers, the number of telephone connections provided remains woefully inadequate.

The number of radio broadcasting stations increased by 1980 to such an extent that 90 per cent of the population (and 78 per cent of the country's area) was covered.[24] But problems remained in respect of the power of the broadcasting transmitters. Television, introduced in the country in 1959, covered in 1981 only about 8.3 crores of people. But the pace of progress accelerated after 1981. Both radio and television services function as government monopolies. The private sector's entry into these fields is not envisaged in the near future.

24. Planning Commission, *Sixth Five Year Plan*, p. 316.

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Labour Legislation and the Trade Union Movement

In India labour legislation was undertaken somewhat in advance of the emergence of labour organisations. The incentive to labour legislation was furnished primarily by the uneasiness of the Manchester cotton manufacturers over the continued growth of the cotton mill industry in Bombay. They made repeated representations to the Secretary of State for India to apply British factory legislation *en bloc* to India so as to neutralise the 'unfair' advantages which the Indian mill industry was enjoying because of its large-scale employment of child labour and long hours of work. On the representation of the Manchester Chamber of Commerce the Secretary of State brought pressure on the Government of Bombay to appoint a Factory Commission to investigate the conditions of work in the Bombay cotton mills. This was in 1875. The Commission were divided on the question whether factory legislation was needed for Indian workers. Representatives of employers on the Commission were vehemently opposed to the idea of regulating working conditions in the factories through legal measures. The Government of Bombay shelved the Commission's Report as the majority did not favour any sort of factory legislation. The Manchester interests, however, continued to carry on their agitation for factory legislation. To this was added the voice of some social workers from Bombay of whom Sorabjee Shapoorji Bengalee was the chief spokesman. He prepared a draft bill for the regulation of child labour in the cotton mills and sent it to the Governor of Bombay. When no action was taken in the matter, he got the draft published in the London 'Times' in September 1878. Shortly thereafter the House of Commons in England adopted a resolution on the necessity of adopting factory legislation in India. Pressure from the Secretary of State ultimately led the Government of India to prepare a bill on the subject. Though the bill was considerably whittled down during discussion, some amount of regulation of labour conditions was introduced when the bill was passed as the Factories Act of 1881.

The Factories Act of 1881 has been described as the result of agitation by "ignorant English philanthropists and grasping English manufacturers." The Act was made applicable to all manufacturing premises using power-driven machinery, employing 100 or more persons and working for more than four months in the year. It regulated the conditions of work of child

labourers only. They could be employed in a factory, as defined above, only if they had attained the age of 7 years. Until they were 12 years of age they could not be employed for more than 9 hours a day and were to be given a rest interval of 1 hour in a day and granted 4 holidays a month. The Act did not apply to plantations and cotton ginning factories. It included a few provisions for the workers' safety such as arrangements for the fencing of dangerous machinery. The inspection of factories was left to be arranged by the District Magistrates who could appoint special Factory Inspectors if necessary. Provisions were also made for the reporting of accidents in the factory.

The limited scope of this Act could not satisfy the Manchester cotton interests. Their representations to the Secretary of State for stricter regulation of the labour conditions in Indian factories continued throughout the next decade. As the reports of factory inspectors appointed under the Act of 1881 brought to light the poor working conditions, the cause of factory labour was also taken up by social reformers in India and England. In 1883 the Government of Bombay was persuaded to undertake another investigation into the working conditions of Bombay cotton mills. The Committee appointed for this purpose received a memorial drawn up on behalf of the workers— the first instance of organised labour action for amelioration of working conditions. The leading part in having this memorial drawn up was played by Narayan Meghajee Lokhanday, a man born to working class parents. At his instance over 5,000 signatures were collected in support of the memorial. After the Committee submitted its findings, the Government of Bombay duly sent a Report to the Government of India, but the latter felt that no action was immediately called for. The Manchester interests did not sit idle, however. In 1887 they sent an English Inspector of Factories to visit factories in India and submit a report. This report strengthened the case for fresh labour legislation. Mr. Lokhanday was also pleading for more action and in 1888 he arranged for a fresh memorial to be drawn up and sent to the Governor-General. Meanwhile an International Labour Conference had been called to meet in Berlin in March 1890. In this Conference resolutions were adopted supporting stricter regulation of hours of women and children in factories all over the territories of the member countries. The British Government had to try to implement these resolutions in India. On the advice of the Secretary of State for India the Governor-General set up a Commission in September 1890 to conduct an inquiry into the working conditions in factories. Mr. Lokhanday was a member of this Commission. After the Commission submitted its report, the Government of India prepared the draft of a new Factories Act, but its provisions had to be further tightened up on the basis of suggestions from London. The Factories Act of 1891 was thus largely thrust upon the Government of India by the Manchester commercial interests acting through the Secretary of State.

The Factories Act of 1891 applied to all establishments using power and employing 50 or more persons. The provisions of the Act could, however, be extended to work-places employing as few as 20 persons at the discretion of the Provincial governments. This Act raised the age of employment of child labourers to 9 and reduced the hours of employment for children below the age of 14 to 7 hours per day. It introduced the system of medical certificates for children employed in factories. The hours of work of female labourers were limited to 11 per day with a 1½ hour period of rest. Children and women were not to be employed in factory premises after 8 p.m. and before 5 a.m. except with special permission. All factories were required to stop work for half an hour between 12 noon and 2 p.m. and to allow a weekly day of rest. They were also to make suitable arrangements for sanitation, ventilation and provision of drinking water for their workers.

After this Act the demand for fresh measures of reform abated for a few years. The cotton industry was then passing through difficult times. But the prosperity of the jute industry in Bengal attracted the attention of the jute manufacturing industry in Scotland. In 1894 the Dundee Chamber of Commerce called for legislative measures to improve working conditions in the jute mills in and around Calcutta. After the introduction of electric lighting in the factories during the 1890s, hours of work were extended in all factories. In some cases workers were required to work for 15 to 16 hours at a stretch. There was a rise in absenteeism and loitering during work which could be attributed to the unusually long working day. Employers themselves began to feel that government intervention was necessary to regulate the hours of work of all classes of labourers, including male labourers who were so long believed to require no State intercession on their behalf. By the early years of the present century, when conditions in the cotton industry improved, both the British manufacturers of cotton and the Indian leaders of public opinion had started pressing their demand for fresh labour legislation on the Government of India. A Factory Commission under Mr. Frere Smith was set up in 1908. Its recommendations were given effect to by the Factories Act of 1911.

The Factories Act, 1911 brought within the scope of factory legislation even seasonal factories working less than four months in a year. It reduced the hours of work of children to 6 per day. Work between 7 p.m. and 5.30 a.m. was prohibited in all textile factories except those working under an approved system of shifts. For male workers in textile factories hours of work were limited to 12 per day. All workers were to be given a half hour break after six hours' work. Provisions for the health and safety of workers were made more stringent and the system of factory inspection was improved through the appointment of a number of full-time factory inspectors.

The early years of the twentieth century also saw the beginning of

legislation for the regulation of working conditions in the mining industry. The Indian Mines Act of 1901 applied to all excavations with a depth of more than 20 feet and undertaken to dig up minerals. Women and children under 12 were prohibited from being employed in a mine on work involving risk. For other workers certain regulations to improve safety conditions and protect health were introduced. The Central Government appointed a Chief Inspector of Mines to supervise the working of the Act, while Provincial governments were authorised to appoint inspection staff for mines in their respective territories.

The First World War saw a considerable growth in the number of factories and with it a slackening of the system of factory inspection. In the interests of production the authorities themselves had to relax some of the provisions of factory legislation during the War. When the war ended a comprehensive review of the existing factory law became necessary. Meanwhile the International Labour Organisation had started working and its Conventions and Recommendations came to play an important part in the re-modelling of labour legislation in India. The trade union movement also became an important factor to reckon with in the post-war period and some of the long-standing demands of working class organisations, such as compensation for employment injury, came to be conceded by the authorities almost immediately after the war.

The Factories Act of 1922 was made applicable to all establishments using mechanical power and employing 20 persons or more. Provincial governments were authorised to extend the provisions of the Act, at their discretion, even to workshops employing no more than 10 persons irrespective of whether they used mechanical power or not. The lower age limit for children was raised to 12 years and no child below the age of 15 could be employed for more than 6 hours a day. For all adult workers, male and female, hours of work were limited to 11 per day and 60 per week. A weekly day of rest was to be provided to all workers and every worker was to be granted an hour's rest after 6 hours of work. Provincial governments were asked to lay down standards of ventilation and other sanitary facilities in the factories. The number of factory inspectors was increased and their technical qualifications were raised.

The Workmen's Compensation Act of 1923 recognised the important principle of employers' liability for all injuries sustained by workmen in the course of their work. Scales of compensation for workers were prescribed, the amount of compensation varying with the workers' wages and the extent of disability suffered. Every Provincial government was required to appoint a Commissioner for Workmen's Compensation for the settlement of all claims arising under the Act. Employers were made liable for reporting to the Commissioner any fatal accident occurring in the factory. The Act also contained a list of occupational diseases which entitled a worker contracting such diseases to claim compensation from his employer.

The Indian Mines Act was amended in 1923. The scope of the Act was extended to all excavations for obtaining minerals, irrespective of depth. Employment of children under 13 for underground work was banned. The weekly hours of work were limited to 54 below ground and 60 above ground. All workers were to be given a weekly day of rest. The Act also authorised the Central government to prohibit underground work for women, but considering the economic difficulties that such a ban would involve for miners' families, the government did not impose any such ban until 1937.

During the closing years of the 1920s labour unrest spread all over India. The Government of India was alarmed at the growing influence of the Russian-inspired Communists over the country's labour movement and had to take measures to counteract this influence. Almost all the prominent Communist labour leaders were put behind prison bars by starting the Meerut Conspiracy Case in 1929. In the same year the Secretary of State announced the appointment of a Royal Commission on Indian labour under the chairmanship of Mr. J.H. Whitley. During the First World War Mr. Whitley had won recognition in England by evolving a system of committees for joint consultation among employers and employees. Under his chairmanship the Royal Commission on Labour carried out extensive enquiries into labour conditions in Indian factories, mines and plantations and brought certain shortcomings of existing legislation to light. The Government of India had to undertake fresh labour legislation in the 1930s to give effect to the Whitley Commission's recommendations, although it was not found practicable to give legal effect to all the reforms which the Commission suggested.

The Factories Act of 1934 arose out of the recommendations of the Whitley Commission. This Act introduced a distinction between 'perennial' and 'seasonal' factories fixing different limits for working hours in the two types of factories. In perennial factories the hours of work were limited to 10 per day and 54 per week, while in seasonal factories they were left unchanged at the previously fixed limits of 11 per day and 60 per week. Hours of work for children were reduced to 5 per day. Workers between 15 and 17 years of age came to be designated as adolescents and could not be employed for full adult work unless they were certified fit for such work by appropriate medical authorities. Overtime work was regulated and higher pay was prescribed for such work. No worker could be assigned work in a factory in such a manner that he would be required to stay on the factory premises for more than 13 hours at a stretch. For children the spreadover of work could not exceed 7½ hours. Provisions for safety and first aid in injury were tightened up. Creches for the use of the children of female workers had to be provided by an employer in certain cases. Ventilation was to be improved and rest rooms provided for workers. Factory inspectors were given more adequate powers so that they could

direct a factory manager to remove such defects in working conditions as might endanger the workers' safety and health.

The Whitley Commission in their report described in detail the plight of the plantation workers in the Assam tea gardens. These workers were recruited from densely populated areas of Bihar and U.P. and were taken to the tea gardens from where they could hardly return to their native provinces. Their wages were very poor and employers dealt very harshly with them. The Commission outlined the type of regulation which they would like to see adopted for the tea garden workers. Following their line of thinking the Government of India adopted in 1932 the Tea Districts Emigrant Labour Act. It provided that recruitment of workers for the plantations must take place through licensed recruiting agents and proper care must be taken of the workers during their onward journey to the tea gardens. The Act contained the important provision that all emigrant labourers would be entitled to repatriation at the employer's expense on the expiry of three years from the date of their entering Assam. In cases of failing health and in certain other circumstances workers might demand repatriation even earlier. The appointment of an official called the Controller of Emigrants was provided for in the Act. This official would be responsible for administering the provisions of the Act relating to transit and repatriation of the plantation workers.

The Indian Mines Act of 1935 was also an outcome of the Whitley Commission's recommendations. This Act limited the working hours in mines to 54 per week for all types of work; for work above ground the daily limit was 10 hours and for underground work the daily limit was fixed at 9 hours. All workers in mines were to be granted 1 hour's rest after six hours' work. The minimum age for employment of children in mines was raised by this Act to 15 years. The health and safety provisions in this Act were further strengthened by three amendments during 1936–40.

Provision was also made in the 1930s for the regulation of hours of work of railway workers and the improvement of conditions of work of dock labourers. The Indian Railways Act of 1890 was amended in 1930 with a new section providing for a weekly maximum of 60 hours' work for railway workers: workers whose duty was of an intermittent nature could be assigned work for 84 hours a week, but not more. Provision was also made for a weekly day of rest for the former category of workers. The Indian Dock Labourers Act, 1934 introduced a number of regulations to improve safety conditions for workers engaged in docks and wharves.

Maternity Benefit Acts were adopted by several Provincial governments during the inter-War period. Bombay led the way in 1929, followed by Central Provinces (1930) and Madras (1935). But attempts to have a Central legislation on this subject proved ineffective.

The Whitley Commission's enquiries had revealed that in the Indian factories workers' wages were not paid in time and were very often with-

held or subjected to fines and deductions on the slightest pretext. The Commission's Report led the Government of India to legislate for the removal of these abuses. The Payment of Wages Act, 1936 provided for the timely disbursement of wages to workers and debarred employers from making deductions from wages unless specifically authorised under the Act. No wage period was to exceed one month and on the expiry of that period wages had to be paid within one week.[1] If a worker was discharged all sums due to him must be paid within two days. Fines and deductions were to be made only after notifying the employees about the nature of the offences for which such fines were liable to be imposed. The fining of children was prohibited. On no account was the fine to exceed more than half an anna in the rupee of the worker's earnings. Recoveries made from workers by way of fines had to be utilised for schemes of workers' benefit.

Another legislative measure taken in the 1930s on the Whitley Commission's recommendation was the Employment of Children Act, 1938. This Act prohibited the employment of children below the age of 15 in handling of goods on the railways and in the ports. The Act was further amended in 1939 to incorporate a provision that no child below the age of 12 could be employed in workshops where certain specified industrial processes (*e.g.*, match manufacturing) were carried out.

The inter-war period also saw the beginning of legislation aimed at the peaceful settlement of disputes between employers and employees. The First World War produced a crop of industrial disputes which continued to plague the industrial scene as long as the post-war boom lasted. The Government of Madras made the pioneer attempts at State intervention in industrial disputes by setting up *ad hoc* courts of enquiry to probe into the causes of such disputes as they arose. These courts were intended only to bring out the facts involved in the dispute but would leave the settlement of the disputes to be evolved in due course under the pressure of public opinion. Need was, however, being felt for more effective agencies which could take the initiative in bringing about a settlement. In 1921 the Government of Bengal appointed a committee to make recommendations on the best method of preventing and settling industrial disputes. This committee did not approve of any system of labour courts to settle disputes between workers and their employers, but preferred joint negotiations on a regular basis. A similar committee, set up by the Government of Bombay in 1922, came to the opposite conclusions. It considered joint negotiations unsuitable for India and advocated a system of adjudication. The Government of India did not move in the matter until another wave of strikes in 1928-29 forced its hands and led it to adopt the Trade Disputes Act—the first legislative measure for active State intervention in the interests of industrial peace

1. For factories employing more than 1,000 workers, 10 days.

The Trade Disputes Act of 1929 was adopted in the first instance only for five years. It provided for the appointment of Courts of Inquiry and Boards of Conciliation, as required, whenever both parties to an industrial dispute would apply for such assistance for the settlement of their disputes. The function of a Court of Inquiry would be to examine the issues involved in a dispute and the contentions of the parties involved, but not to give any binding judgment. The functions of a Board of Conciliation would be to induce the parties involved in an industrial dispute to come to a reasonable settlement, but not to force them to agree to any course of action suggested by the Board. The Board was to try every means to produce an agreement between the two parties and, in the event of failure to do so, was to submit a report to the government outlining the steps taken by it for the settlement of the dispute.

The Trade Disputes Act also curbed the right to strike to a certain extent by providing that (*a*) in the public utility services employees were required to serve a notice of not less than 14 days before going on a strike, and (*b*) strikes engaged in for purposes other than the furtherance of a direct dispute between workers and employers or strikes inflicting severe hardship on the community were to be considered illegal. Penalties were provided for workers joining such strikes.

Although the Trade Disputes Act was put on the Statute book in 1929, very little use was made of it in the ensuing years. Only after popular Ministries came to function in the Provinces in 1937 was the Act made use of to a greater extent. In 1938 the Act was amended primarily for the purpose of authorising Provincial governments to appoint a permanent staff of full-time conciliation officers whose services would be available to parties for mediation in industrial disputes.

Meanwhile the Government of Bombay had in 1934 passed the Trade Disputes Conciliation Act which led to the appointment of a staff of conciliators who would actively participate in the negotiations between employers and the trade unions. The Act also provided for the appointment of a Labour Officer in factories to look after the interests of workers. A more stringent measure was taken after industrial disputes increased towards the end of the 1930s as prosperity returned to some extent in the Bombay cotton mills. In 1938 the Bombay Industrial Disputes Act introduced for the first time the principles of compulsory conciliation and voluntary arbitration. The former implied that all parties to an industrial dispute were required to refer their disputes to an appropriate agency for settlement and could not resort to strikes or lock-outs until conciliation proceedings were gone through. The principle of voluntary arbitration was to be found in the provision that the disputing parties were free at any time to refer their dispute to an Industrial Court, specially constituted under the Act. This Court was also to act as the final court of judgment in all cases relating to labour disputes.

The Provincial governments installed in 1937, after the elections under the Government of India Act 1935, took a great deal of interest in matters relating to industrial labour. At their instance committees were set up in several Provinces to make exhaustive enquiries into the conditions of workers in the important industrial centres of the country. The Bombay Labour Inquiry Committee (1937), the Kanpur Labour Inquiry Committee (1938) and the Bihar Labour Inquiry Committee (1938) submitted reports containing much useful information about working class living conditions in India.

As the Second World War broke out the number of industrial disputes at first rose. The rise in the cost of living during 1939–40 led workers in many industrial centres to go on strike for realising their demand for 'dearness' allowances. In January 1942 the Government of India took action under the Defence of India Act (Rule 81A of the D.I. Rules) to restrain strikes and lock-outs in the interests of war production. All strikes or lock-outs were declared illegal unless a fortnight's notice was given. Any dispute could be referred to conciliation at the government's discretion. In suitable cases a dispute could also be referred to adjudicators if the government so decided and the awards of such adjudicators would be binding on both parties to an industrial dispute. Compulsory adjudication which thus came to be introduced as a wartime emergency measure was later continued as a more or less permanent feature of industrial disputes legislation in India.

During the war years a number of measures were adopted to improve the efficiency and morale of the working class in the interests of war production. The Weekly Holidays Act of 1942 provided a weekly holiday for all shop workers and authorised Provincial governments to declare at their option another day in the week as a half-holiday. The Factories (Amendment) Act of 1945 introduced a system of paid annual holidays for all factory workers, an adult worker being entitled to 10 days' leave and a child worker to 14 days' leave after one year's service. A Central Maternity Benefit Act for women workers in the mining industry was put on the Statute book in 1941. Mine workers, a particularly unorganised group, were also the beneficiaries of such welfare legislation as the Mica Mines Labour Welfare Fund Act (1946), Coal Mines Labour Welfare Fund Act (1947) and the Coal Mines Provident Fund and Bonus Schemes Act (1948). The origin of inspiration for such welfare legislation must be traced to the important Report of the Whitley Commission.

Moreover, in 1944 the Government of India set up the Labour Investigation Committee, presided over by Mr. D.R. Rege of the Indian Civil Service, to implement a Resolution adopted at the Tripartite Labour Conference in September 1943. The Rege Committee prepared a set of useful reports on labour conditions in different industrial, mining and plantation centres.

The findings of this Committee were the basis of most of the labour laws adopted in this country during the period 1946–50.

At the time of the transfer of power in 1947 Indian industries were passing through a phase of depression. The post-war inflation was raging in full force, while installed industrial capacity remained underutilised owing to social and political turmoil in the country and various bottlenecks which were largely a legacy of the war. The newly constituted Government of India took early action to bring together employers' and workers' representatives in a conference where both parties were persuaded to accept a period of Industrial Truce. At the same time the government pledged itself to a Five-Year Labour Plan under which ameliorative measures were to be adopted and machinery for the peaceful settlement of labour disputes was to be set up.

Under the programme so outlined several laws were enacted during 1947–50. The most important of these were the Industrial Disputes Act (1947), the Factories Act (1948), the Minimum Wages Act (1948) and the Employees' State Insurance Act (1948).

The Industrial Disputes Act of 1947 provided for both conciliation and arbitration in the settlement of industrial disputes. A dispute could be referred to a Board of Conciliation after the efforts of Conciliation Officers to bring about a settlement failed, the officer concerned being required to report his success or failure within 14 days of the commencement of the conciliation proceedings. At the discretion of the appropriate authorities such a dispute where the initial efforts at conciliation have failed could also be referred to a Tribunal for adjudication. Disputes in public utilities were invariably to be referred to a Tribunal. Where necessary the authorities could also set up Courts of Inquiry to investigate into any matter connected with an industrial dispute. Strikes and lock-outs declared during the conciliation or arbitration proceedings were declared illegal. When the conciliation proceedings would result in an agreement, such an agreement would be binding on the parties for at least six months or for such longer periods as might be agreed upon by the parties. In the case of a binding award given by a Tribunal, the parties would be bound by its terms for not more than one year or for such shorter periods as might be fixed by the authorities. In the public utilities notices of strikes or lock-outs had to be given at least 14 days prior to the event but not more than six weeks earlier.

A feature of the Industrial Disputes Act was the institution of a system of Works' Committees in all industrial establishments employing 100 or more workers. The Works Committee was to be formed with representatives of both employers and workers, the number of workers' representatives being at least equal to the number of employers'. The workers' representatives were to be chosen in consultation with their trade unions whenever registered unions functioned in the work-unit concerned. The

Works Committees were intended to promote measures to secure amity and good relations between the workers and their employers and to discuss matters of common interest with the object of composing any differences that might exist between the two parties.

The Factories Act of 1948 extended the scope of factory legislation by making the Act applicable to all power-using establishments employing 10 or more persons. In the case of establishments not using mechanical power the Act would apply only if they employed 20 or more workers. At the discretion of Provincial governments the Act could be extended to regulate working conditions in even smaller establishments. The old distinction between seasonal and perennial factories was now abolished and the working hours in all factories were limited to 9 per day and 48 per week. Overtime work was permitted subject to certain maxima and the hourly rate for overtime work was fixed at twice the ordinary wage. The minimum age for employment of children was raised from 12 to 14 and their hours of work were limited to 4½ per day. The upper age limit of an adolescent worker was raised to 18 years. Persons between the ages of 15 and 18 were required to be employed for 4½ hours per day, like children, unless they had been certified fit to work as adults. Women employees were in no circumstances to be required to work for more than 9 hours a day. Women and children were not to work in a factory after 7 p.m. and before 6 a.m. All workers were entitled to half an hour's rest after 5 hours' work.

The Act continued the provisions of holidays with pay which had been introduced as a temporary measure in 1945 during the Second World War. A worker was entitled to paid holidays calculated at the rate of one day for 20 days' work subject to a minimum of 10 days per year. For a child worker the provisions were more liberal: he (or she) was entitled to one day's leave for every 15 days worked subject to a minimum of 14 days in the year.

Provisions relating to health and safety of the workers in a factory were further strengthened by this Act. Every factory employing 500 or more workers was required to employ a Welfare Officer and representatives of the workers were to be associated with the welfare arrangements in a factory. The penalties provided for departing from the provisions of the Act were made more stringent than in the earlier Factories Acts and the system of factory inspection was considerably improved.

A very significant measure, also adopted in 1948, was the Minimum Wages Act. This was the first enactment involving statutory regulation of the wage level, as distinct from the regulation of the wage period which the Payment of Wages Act had introduced. The scope of the Act was limited to 13 relatively unorganised industries where workers were likely to be 'sweated'. These industries were: woollen carpet making and shawl

weaving, rice mills and flour or dal mills, tobacco (including *bidi*) manufactories, plantations, oilmills, road and building construction, stone breaking or crushing, lac manufacturing, mica manufactories, public motor transport, tanneries and leather works, work under local authorities, and agricultural operations including farming, dairy, horticulture, poultry, forestry and timber works.

Under this Act the Central and Provincial governments were empowered to fix minimum rates of wages for different categories of workers in the occupations specified above. Different wage rates could be fixed for different types of work and for different groups of workers. The Act enjoined upon the governments to fix appropriate minimum wages within two years of the coming into force of the Act; in the case of agriculture the period allowed was three years. Subsequently the period had to be extended for various practical difficulties.

Wages fixed by statute were to be reviewed at least once in five years. In revising the rates once fixed the governments were to appoint advisory committees consisting of representatives of employers and employees in equal numbers and several independent members not exceeding one-third of the total membership of a committee. To coordinate the work of the different advisory committees the Central government was to appoint a Central Advisory Board for the purposes of the Act and with a composition similar to that of the advisory committees.

Employers in the above-mentioned occupations were required to maintain registers and records of their employees and of the wages paid to them and to make these available to Inspectors appointed by the government for scrutiny. Any employer who might be detected as paying less than the prescribed minimum wages to an employee would be liable to penalties which could extend up to six months' imprisonment or a fine of Rs. 500 or both.

The Minimum Wages Act did not itself prescribe the scale of minimum wages but left the details to be drawn up later by the appropriate authorities. The wage rates were to come into force three months after notification in the official gazette. Before such notification the government's proposals were to be either scrutinised by a committee appointed for the purpose or published for the filing of objections by interested parties, a period of two months being given for the filing of such objections.

The Government of India also adopted its first comprehensive social security legislation in 1948. In the period after World War II social security measures were being strengthened in almost every country. Britain, for example, had made larger benefits available for sickness and old age on the basis of the famous Beveridge Report. The United States was revising its social security measures under the Wagner-Murray Plan. In India during the Second World War Prof. B.P. Adarkar had been asked to study the subject of health insurance for industrial workers. In his Report

published in 1944 Prof. Adarkar had outlined a scheme for social security payments for industrial workers during sickness, employment injury and similar contingencies. This scheme was subsequently examined by Maurice Stack and Raghunath Rao who were deputed to the Government of India by the International Labour Organisation. On the basis of the Adarkar Report along with the Stack-Rao modifications, the Government of India introduced an Employees' State Insurance Bill before the Central Legislature in November 1946. It was approved by the Central Legislature in April 1948.

The Employees' State Insurance Act was intended to make provisions for both cash and medical benefits for workers and their dependants in cases of sickness, maternity and employment injury. Cash benefits were to be paid from a fund, called the Employees' State Insurance Fund, which was to receive weekly contributions from both employees and their employers. The contribution of an employee was to vary in relation to his average daily wages, a worker with a wage of less than one rupee per day being exempt from contributions. The employer's weekly contribution was to be about Re. 0.40 for each employee earning less than Rs. 1.50 per day; for employees earning more than this amount the employer's contribution was to be double that of the employee.

The E.S.I. fund was to be used for making available four kinds of benefits: (*a*) sickness benefit, (*b*) maternity benefit, (*c*) disablement benefit, and (*d*) dependants' benefit. All eligible employees were to receive, in the case of sickness, a regular cash payment for a maximum period of 8 weeks, provided that their sickness had lasted for more than three days. The amount of cash benefit in sickness was to be computed at half the average daily wage for a particular group of workers, workers being divided into eight groups for this purpose. Maternity benefit was payable to all eligible women at the rate of Re. 0.75 a day for a period of 12 weeks. The disablement benefit was payable to employees disabled by injury sustained in course of employment. The payment was to be at the same rate as the sickness benefit; the period of payment could be as long as the rest of his life if the employee was totally disabled by the injury. The dependants' benefit was to be paid to the widow and children of a worker who died as the result of an employment injury. The rate of payment to a widow was to be three-fifths of what the disabled worker would have been entitled to receive and to each child two-fifths of such amount until the child reached the age of fifteen.

The Act also provided for free medical benefits to sick workers and members of their families. Medical benefit was also made available to workers in cases of maternity and employment injury. The scale of medical benefit to be provided was to depend upon the Provincial governments which had to enter into agreements in this respect with the Employees' State Insurance Corporation with a view to sharing expenses.

The E.S.I.C. was the authority constituted under the E.S.I. Act to administer the scheme of State insurance. It was formed with nominees of the governments, both Central and Provincial, of employers' and employees' representatives, of the medical profession, and of the Central legislature. Members were appointed for a term of four years at a time. The executive functions of the E.S.I.C. were to be discharged by a 12-member Standing Committee which was to be re-constituted once every two years. The chief executive officer of the E.S.I.C. was the Director-General of Employees' State Insurance. For the administration of medical benefit under the Act the Central government constituted a Medical Benefit Council and appointed a Medical Commissioner.

The benefits of State insurance were initially made available to employees who earned not more than Rs. 400 a month. The Act was implemented in stages, different industrial regions being brought within the scope of the insurance scheme by notification. In 1950 the benefits of the Act had been made applicable only to workers in Delhi and Ajmer-Merwara, but preparations were going on for extending such benefits to other areas.

A Critical Review of Indian Labour Legislation

The Government of India has been criticised by both employers and employees for its policies relating to labour. The employers have considered the government's labour legislation programme as ambitious and imitative, completely unrelated to the needs of the situation in India. In their view, the obligations imposed on employers under the various labour laws contribute, directly and indirectly, to raise the cost of production and weaken India's competitive position in the international markets. As for the employees, they have particularly resented the government's legislative and administrative measures curbing their right to declare a strike. The requirement that a fortnight's notice should be given to employers before resorting to a strike reduces the effectiveness of the strike as a weapon. The further requirement that no call for strikes or lock-outs can be given so long as conciliation proceedings are pending puts a premium on intransigence and forces the workers to yield to employers' pressures, since the latter can afford to wait for the outcome of conciliation measures while the former cannot. The employees further complain that employers can contravene many of the provisions of labour legislation with impunity or with very light penalties.

Generally speaking, India had, by 1950, built up one of the most comprehensive labour codes to be found in any country at India's level of economic development. The standards laid down by the International Labour Organisation had been accepted and measures were being worked out to attain those standards. However, the implementation of these measures suffered because of the paucity of inspection staff and the backward state

of organisation among the workers. The best sanction of labour legislation in any country is the strength of the trade unions. Acting as watch-dogs on behalf of society, the trade unions can ensure that the intention of the legislature is not flouted by the managing and supervising staff on the factory floor. They can also act as a check on unhealthy collusion between employers, the inspection staff and a section of the workers for violating the provisions of the law. In India trade unions have existed at least since the early years of the present century. But their number has been small and for various organisational deficiencies their effectiveness has been rather limited. To understand the reasons for the frequent infringement of labour legislation in India, which goes undetected and unpunished, one has to turn one's attention to the state of labour organisation in the country.

The Labour Movement in India

The rise of a class of wage labourers in the middle of the nineteenth century brought India face to face with some of the problems of modern Capitalism. The modification of the wage bargain by some sort of collective action on the part of the wage-earners, the establishment of better working conditions through the exertion of joint labour pressure on the employers and the State, and the political education of the worker through working class organisations, functioning not sporadically but in a continuous manner, came within the bounds of possibility.

The first Factory Commission, we have seen, was appointed in 1875. Though this Commission recommended certain measures for the regulation of conditions of work in the cotton factories, the Bombay Millowners' Association launched an agitation opposing "vexatious and useless restrictions" in matters relating to labour and the Government of India was persuaded to drop the draft legislation which was prompted by the Commission's recommendations. At this stage some philanthropists of Bombay, led by Sir Sorabjee Shapurjee Bengalee, took up the cause of the mill workers and, having drafted a bill, sent it to the Governor of Bombay for his consideration (April 1878). The Poona Sarvajanik Sabha also added its voice to the demand for labour legislation. A number of mill workers led by one Raghave Succaram presented a memorial to the legislative council in support of Mr. Bengalee's bill. Thus although the influence of Lancashire cotton mill owners played a decisive role in Indian labour legislation in the initial stage, the workers' point of view did not go entirely unrepresented. Social organisations, rather than class organisations of the workers, were instrumental in impressing upon the government the need for legislative intervention with factory conditions.

In 1883 a Factory Committee was set up by the Government of Bombay to investigate the working of the Factories Act of 1881. This created an

occasion for some social workers, notably Narayan Meghajee Lokhanday of Bombay, to bring together the workers on a common platform. A memorial was drawn up on behalf of the workers and sent to the Chairman of the Bombay Factory Committee (November 1884). The memorial put forward the following demands: a weekly day of rest for all workers, a daily recess for half an hour, regular hours of work with abolition of night work, regularity in wage payment, and compensation for employment injury. About this time Lokhanday started publication of "Dinabandhu", the first labour journal in India.

By the time the Factory Commission of 1890 was set up, the idea had won acceptance that the workers' viewpoint must be ascertained before any fresh measure of labour legislation was taken up Accordingly the Commission was asked to nominate one representative of the workers from the Province in which they might be carrying on their inquiries. The Commission examined 96 workers as witnesses before finalising its Report.

The Bombay Millhands' Association formed in 1890 may be regarded as the earliest working class organisation in India, although it is doubtful how far it functioned on a continuous basis. Its main work seems to have been to draw up petitions addressed either to the Factory Commission which was investigating labour conditions during that period, or to the Governor-General and the Millowners' Association. The main demand related to a weekly holiday, preferably on Sundays. This demand was conceded by the Factories Act of 1891.

The tea plantations of Assam were the scene of intense conflict between the planters and the indentured workers. The professional recruiters (*arkathis*) took the workers to the plantations by painting a rosy picture of working conditions there, but on arrival the workers would find nothing but a disguised form of slavery. The contract of employment, once signed, prevented them from leaving their jobs even if they wanted to do so. The tales of woe of the Assam plantation workers reached social workers in Calcutta and elsewhere and a movement was set on foot to redress the grievances of the workers there. A social reformer of the Brahmo Samaj, Dwarakanath Gangopadhyay, visited the tea plantations disguising himself as a coolie, since no outsiders would be admitted to the plantations. His reports, published in the Bengali 'Sanjibani' edited by Krishna Kumar Mitra and the English daily 'The Bengalee' edited by Surendra Nath Banerjee, gave valuable publicity to the plantation workers' cause. In 1888 the Bengal Provincial Conference adopted a resolution calling for the abolition of slave trade in the tea gardens of Assam.

Among the jute workers of Bengal were also to be found the early stirrings for organisation to bring about an improvement in working conditions. Sasipada Banerjee was the leading spirit in this movement. He

founded the Baranagar Institute to work among the jute workers in the neighbourhood, established a Saving Bank to promote thrift among the workers and started a periodical called the 'Bharat Sramajibee'.

Cases of workers refusing to work until the redress of their grievances were occasionally reported almost ever since the factory system of working began. Thus Buchanan reports a cessation of work by some workers in the Empress Mills, Nagpur, in 1877.[2] Other instances of such action on the workers' part can be found in the closing years of the nineteenth century. But these strikes by workers were usually sudden and sporadic, without the backing of any established workers' organisations. It was only in the 1890s that strike committees began to come into existence and the cessation of work by the workers began to assume a deliberate character. The strikes in Bombay cotton mills in 1892 and the jute workers' strike in Budge Budge (Bengal) in 1895 seem to have been called to demonstrate the workers' solidarity behind their demands.

The position of the working class became very strong in Bombay during the period of intense labour shortage in that city caused by the plague epidemic in 1896–97. The workers, for instance, could get the employers accept their demand for daily payment of wages instead of monthly payments. When the situation became normal and workers came back to join the mills in larger numbers the employers wanted to re-introduce monthly payments, but had to retreat in the face of workers' opposition. In July 1897 a general strike was staged on the issue of bonus payments. This strike was marked by a new militancy which was never observed before. The workers were slowly, but surely, being welded into a strong force, determined to fight their own battle against employers. But trade unions, properly so called, were yet to come into existence.

The next phase in the development of the labour movement coincides with the political upheaval in Bengal following the partition of Bengal in 1905 (the 'Swadeshi' Movement). Political and social workers in Bengal started working among the wage earning classes in a more systematic manner than hitherto and succeeded in bringing them together in several struggles, particularly against the European masters. Under the auspices of the Printers' Union, Calcutta, which worked in fact as a strike committee, the workers in the Government of India Press struck work for about a month in 1905 and succeeded in getting most of their demands accepted. The workers of the Eastern Bengal Railways went on a strike the same year and in 1907 there was a strike by the workers of the Samastipur Railway Workshops. In Bombay the workers went on a 'political' strike for about a week when Bal Gangadhar Tilak, the nationalist leader, was sent to prison for a six-year term in 1908. In the same year there was an all-India Telegraph workers' strike. Though there was as yet no established

2. Buchanan, D.H., *Development of Capitalist Enterprise in India*, 1934, p. 416.

all-India organisation of the Telegraph workers, the strike action was very successfully coordinated. Again, throughout the period before the First World War the working day in the factories was being extended, night work being now made possible by the introduction of the electric light. The workers resented this excessive demand on their time and energies and occasionally resorted to strikes to ventilate their grievances. The working class was gaining in solidarity and some amount of organisational activity was now noticeable. These organisations, however, were modelled more on the lines of Mutual Aid Societies than on those of trade unions. Among the earliest instances of such working class organisations may be cited the Amalgamated Society of Railway Servants of India and Burma (1897), the Kamgar Hitvardhak Sabha, Bombay (1909), the Postal Unions in Calcutta and Bombay and the Indian Telegraph Association (1908). The Mohammedan Association, formed in Calcutta in 1895, was a forum for workers belonging to a particular community and engaged in works of common benefit. The Indian Labour Union, also of Calcutta, was perhaps too short-lived to deserve mention.

The First World War not only brought about a considerable increase in the number of factory workers, but also invested them with a new awareness of their strategic importance as a social class. At the same time the rise in consumer prices, the relatively poor working conditions in many of the hastily constructed factories and the general feeling of insecurity among worker who were coming more and more to be permanently detached from their village moorings added to the necessity for working class agitation against the existing set-up. Both the political unrest inside the country and the revolutionary upsurge in Russia and Eastern Europe influenced the thinking and attitudes of the leaders of the working class movement in the immediate post-war period.

The Madras Labour Union formed in 1918 can be regarded as typical of the institutions which were coming to work among the industrial labourers during this period. It arose as a textiles industry union and proved durable, later extending its membership to workers in several other industries. It had a fairly large membership with regular subscriptions collected from members. For all these reasons it is generally regarded as the first Indian trade union of the modern type.

The name of B.P. Wadia is intimately associated with the Madras Labour Union. Wadia was an ardent worker in the political field devoting himself to the Indian Home Rule Movement which was being carried on at this time under the leadership of Mrs. Annie Besant. Wadia's main purpose in entering the labour field was to carry the political movement to the factories, his principal target being the European-managed factories. Thus the Madras Labour Union was hardly inspired by economic grievances of the workers; it was more concerned with the personal relations between European mill assistants and the Indian workers in the textile mills managed

by Messrs. Binny and Company, a British managing agency group in Madras.

About the same time attempts were being made to organise mill workers in Ahmedabad, Bombay and other industrial centres. In Ahmedabad several unions, initially formed by workers following the same craft (*e.g.*, weavers, spinners, sizers, etc.) were amalgamated into the Ahmedabad Textile Labour Association in 1920. A leading role was played in this organisation by the associates of Mahatma Gandhi. Trade unions were also coming into existence in the cotton mills of Bombay. The railway workers and the operatives in the iron and steel industry were also coming under the spell of unionism. Not all of these unions were, of course, equally stable. Many of them came into existence as strike committees and dwindled in importance after staging a strike or two by their members.

Strikes began to occur frequently since the closing months of 1918. A general strike of all cotton mill workers in Bombay was called in January 1919 and caused serious unrest in the city. Next year (1920) Bombay saw another general strike in the textile industry, the workers staying out of work for a full month. There were a number of strikes in the Kanpur woollen industry, in the Calcutta jute mills, in railway workshops in Bombay and by cotton mill workers in Ahmedabad and Sholapur. The Ahmedabad workers' strike deserves special mention because it was led by Mahatma Gandhi according to principles of action which have left an abiding mark on a section of labour leaders in India. The strike came to be regarded by them, not as an instrument of class struggle against capitalist employers, but as a weapon for securing justice by following the paths of truth and non-violence. At the same time, the principle of voluntary arbitration by a jointly nominated arbiter came to the be held up as the most satisfactory method of solution of disputes in a modern industrial society.

The establishment of the International Labour Organisation in 1919 and India's membership of this organisation hastened the formation of a common forum for all trade union workers in India who came together in the All-India Trade Union Congress formed in October 1920. The first session of the A.I.T.U.C. was held in Bombay in November 1920 under the presidentship of Lala Lajpat Rai. In his presidential address Lala Lajpat Rai pointed to the need for an all-India organisation among workers since they had to struggle against both the Government and the employers who were organised on an all-country basis. At the time there were many who felt that the time for a countrywide organisation of labourers had not yet arrived in India. But the promoters of the A.I.T.U.C., notably Mr. N.M. Joshi, wanted to give a cohesive character to the labour movement in the country. They took the British trade union movement as their model. The very name 'Trade Union Congress' was borrowed from Britain. The idea of building up the trade union movement as an adjunct

to the national movement led by the Indian National Congress may also have played some part in the choice of the name.

For several years the A.I.T.U.C. lived without a formal constitution and without much attempt to build up organisational links with individual unions. It held an annual session usually towards the end of the calendar year where one of its most important resolutions related to the choice of workers' representatives at the I.L.O. session in Geneva. In the initial years there were several strands of thinking among the labour leaders who played a prominent part in the A.I.T.U.C. Mr. N.M. Joshi and his camp-followers wanted the labour movement to develop independently of the political movement for national liberation. They wanted trade unions to be concerned more with immediate economic issues than with social or political issues. A second group, of which Lala Lajpat Rai may have been an ardent supporter, wanted the working clas to develop its own political thinking and organisation, just as the British working class had come to form the British Labour Party. Another school of thinking favoured a close link-up between the Indian National Congress with its all-India political following and the trade union movement. In addition to these three ways of thinking inside the country, the international Communist movement also started influencing the A.I.T.U.C. at least since 1922. Communist workers started building labour organisations in Bombay and Calcutta from 1923 onwards and their aim to bring the Indian labour movement within the fold of the international Communist movement became manifest in 1924 when at the Calcutta session of the A.I.T.U.C. slogans were raised in support of international Communism. The Comintern was actively financing and helping in other ways the newly oncoming trade unions which were only too eager to proclaim their special character as organisations of the working class, while the older trade unions were characterised, not incorrectly, as organisations run for the workers by interested middle-class leaders. On the political plane the Communists started a Workers' and Peasants' Party in 1928.

After 1922 the textiles industries were passing through an economic depression and the trade unions did not find it opportune to press their demands on the employers. But beginning from 1926 there was again a spate of strikes in Bombay mostly under the influence of Communist leaders In 1927 the Communists succeeded in capturing a key post in the A.I.T.U.C. when Mr. S.V. Ghate, a Communist labour leader, was elected as one of the secretaries in the organisation. The first day of May 1927 was celebrated by Bombay Communists and their followers as Labour Day, the first ever observation of the May Day in India. The Girni Kamgar (Red Flag) Union of textile workers in Bombay, set up in 1928, soon became a powerful union under Communist leadership and played a leading part in the general strike of 1928 which lasted for over six months as well as in the

general strike of 1929. Another powerful union under Communist influence was the G.I.P. Railway Union.

The Government of India was concerned at the growing Communist influence on the Indian labour movement and, while ameliorative measures were taken to pacify the working class, the Communist leaders of the working class movement were put up for trial in the Meerut Conspiracy Case of 1929. It is doubtful whether this removal of the leaders from the scene for the time being remedied to any extent the newly found militancy of the working class movement in India.

The split between the moderates in the trade union movement led by Mr. N.M. Joshi and the militant Communist group which was widening for a number of years finally came to a head in the Nagpur session of the A.I.T.U.C. held in 1929. The moderate group left the parent body and formed the Indian Trades Union Federation. The Communists, together with the more militant section of the country's nationalists, took over the A.I.T.U.C. But this union between the Communists and the ultra-nationalists did not last for more than two years. In 1931 the communist group left the A.I.T.U.C. and formed their own rival all-India organisation, called the All-India Red Trade Union Congress. This organisation played a leading part in the strikes occurring in different industrial and mining centres during 1933-34, but as the country was passing through a deep industrial and agricultural depression most of these strikes failed to produce any economic benefits for the workers. Meanwhile the Government of India once again decided to come to grips with the Communist elements in the labour movement. The Communist Party was banned and a number of trade unions were declared illegal because of their engaging in unlawful political activities. With the Communist influence thus waning the All India Red Trade Union Congress merged with the A.I.T.U.C. in 1935. At about this time a Socialist group was formed in the Indian National Congress. This group also joined the A.I.T.U.C. and worked for restoring unity in the Indian labour movement for the next few years. The Indian Trades Union Federation was accepted back into the A.I.T.U.C. in April 1938, when certain conditions put forward by the Joshi group were accepted by the leaders of the A.I.T.U.C. With the outbreak of the Second World War there occurred another split in the A.I.T.U.C. when a group of trade union workers led by Mr. M.N. Roy founded the Indian Federation of Labour in November 1941. The difference developed over the definition of the working classes' attitude towards the Second World War. While the A.I.T.U.C. as a whole wanted to maintain an attitude of neutrality, the Royists advocated active participation of the Indian working class in what they believed to be an anti-Fascist war.

The growth of trade unions in the inter-war period was speeded up due to many causes. Perhaps the most important factor was the sharp accentuation of political conflicts, both between the British and the Indian nation-

alists and between the nationalist thinkers and the international-minded Communists. By 1926, when the Trade Unions Act was adopted by the Indian legislature, there were about 60 trade unions in the country affiliated to the A.I.T.U.C. with nearly 1.5 lakh members. This does not take account of the organisations of Government employees which had another 50,000 on their membership lists. In 1927–28, the first year of registration of unions under the Trade Union Act, only 29 trade unions with a membership of 101,000 were registered. By 1940–41 the number of registered trade unions rose to 727 and their membership to over 5 lakhs. In spite of the depressed economic conditions in the 1930's membership of trade unions rose steadily. With the revival of the economy after 1937 there was a faster rate of growth of membership. Industries which had earlier remained unaffected by unionism began to be drawn into the trade union movement in the early years of the Second World War.

The A.I.T.U.C. continued to be used as a common platform by the nationalist trade union leaders and their Communist counterparts up to 1942. In that year the Communists changed their attitude towards the Second World War, now regarding it as a 'people's war', as, with the entry of Russia into the war, the character of the war had completely changed. The A.I.T.U.C. was dominated by the Communist group for the remaining years of the war. The nationalist leaders were forced to evolve their own line of action in those working class centres, *e.g.*, Ahmedabad and Jamshedpur, where their following was still strong.

The Indian Federation of Labour under the Royists grew very strong in the labour field during the war years. With its policy of support to the war from the very early days of the war, it enjoyed the patronage of the Government of India. When the I.F.L. was formed in 1941 only about 100 unions were affiliated to it. By 1944 the number of affiliated unions rose to 222. It claimed a membership of 3 lakhs in 1941 and over 4 lakhs in 1944. In 1943 the I.F.L. staked its claim to be declared as the only representative organisation of the Indian working class and asked the Government of India to cease nominating A.I.T.U.C. representatives to workers' conferences. The Government of India could not at that time investigate the relative membership strength of the two central labour federations and adopted a policy of nominating workers' representatives from both the organisations in alternate years. After the war the Government of India set up an Inquiry Committee in 1946 under the Chief Labour Commissioner to ascertain the representative character of the two rival organisations. On his recommendation the A.I.T.U.C. came to be recognised once again as the most representative central federation of Indian trade unions.

During the Second World War there was a tremendous spurt in industrial activity which created an opportunity for trade union leaders to bring more workers into the union fold. The importance of unionism was enhanced by the new labour policy of the government which laid stress on tri-partite

consultation machinery in all matters relating to labour. The Indian Labour Conference, consisting of representatives of employers, trade unions and the government, came to be established in 1942. One feature of trade unionism during the Second World War was the unionisation of larger sections of the white-collar employees.

The post-war years with their problems of retrenchment and rising costs of living gave further impetus to the trade union movement. The emphasis given in Indian labour policy on adjudication of labour disputes called for the existence of labour unions in every industrial or commercial organisation where employer-employee disputes could crop up. Political parties have also been active in multiplying the number of unions subscribing to their own creeds. For all these reasons there was a sharp increase in the number of registered trade unions and their membership. In 1950-51 there were 3,766 registered trade unions in India. The number of unions submitting returns to the Registrars of Trade Unions was only 2,002. Among them they had 17.57 lakh members. The average number of members per trade union, an indicator of trade union strength, has been declining in recent years as the unions have spread to smaller work-places and workers have been split by political loyalties.

The domination of the A.I.T.U.C. by the Communist group had set nationalist trade union leaders a ticklish problem. If they broke away from the A.I.T.U.C. and formed their own federation, they would be charged with injecting politics into the trade union movement. If they stayed with the A.I.T.U.C. they would be unable to check what many of them characterised as 'leftist misadventures'. The problem assumed great importance on the eve of the transfer of power in 1947. The prospects of a Congress government with a Communist-led A.I.T.U.C. at the helm of the labour movement was none too pleasing to the would-be rulers of the country. Accordingly the Working Committee of the Indian National Congress in their resolution of August 13, 1946. advised Congressmen to withdraw from the A.I.T.U.C. and build up their own national labour organisation. The Indian National Trade Union Congress was formally inaugurated at a conference of Indian National Congress leaders and trade unionists opposed to the Communist ideology on May 3, 1947. It was supported by over 200 trade unions claiming a membership of over 5.7 lakhs. By 1950 the I.N.T.U.C. grew much stronger than the A.I.T.U.C. in the number of affiliated unions as well as in membership. The I.N.T.U.C. had 1,043 affiliated Unions with 14.3 lakh members, while the A.I.T.U.C. claimed 722 unions with 7.3 lakh members. In June 1948 the I.N.T.U.C. was recognised as the most representative national federation of trade unions.

The Congress Socialist Party which cooperated with the sponsors of the I.N.T.U.C. in 1947 were forced to leave the Indian National Congress the very next year and started their own central federation, the Hind Mazdoor Panchayat, in December 1948 In 1949 the remnants of the Indian Federa-

tion of Labour merged with this federation which came to be re-christened as the Hind Mazdoor Sabha. In 1950 it had 306 affiliated unions and claimed 3.3 lakh members.

A number of political and non-political groups which had left the A.I.T.U.C. in 1947 but could not see eye to eye with the policies adopted by either the I.N.T.U.C. or the H.M.S. launched their own central federation, the United Trade Union Congress, in April 1949. In 1950 the number of unions affiliated to the U.T.U.C. was 460 and membership claimed was 6.99 lakhs.

Besides these four central federations of trade unions, there existed a number of all-India working class organisations which functioned independently of the central federations. The most prominent unions in this class were the National Federation of Indian Railwaymen, the All-India Port and Dock Workers' Federation and the All-India Mine Workers' Federation. Most of the unions of middle-class (white-collar) employees which were organised in the post-war period have not sought affiliation with any of the central federations. Examples are the All-India Bank Employees' Association, the Confederation of Central Government Employees and the Insurance Workers' Federation. The multiplicity of unions, often working for conflicting courses of action inside the same work-place, creates problems for workers, employers and the government alike; simple solutions to such problems are not yet within sight.

Trade Union Legislation

The early workingmen's associations did not usually seek legal recognition or, if they did, were legalised according to the provisions of the Company Law. The Amalgamated Society of Railway Servants formed in 1897 was incorporated under the Indian Companies Act of 1882. Under the English Common Law an association of workers seeking to interfere with the freely struck bargains between employers and their workers, such as a trade union, was regarded as based on an agreement in restraint of trade. As such it was liable to legal suppression. Advantage was taken of this legal loophole in 1920 by Messrs. Binny & Co. in their dispute with the Madras Labour Union. Mr. B.P. Wadia and nine other office-bearers of the Union were charged with the offence of inducing workers to break their contract of employment and sued for damages. The Madras High Court granted a decree in favour of the Company for Rs. 75,000. It then became clear that, if trade unions this country were to function without obstruction, legal protection on the lines enjoyed by British trade unions must be made available to them. With this end in view Mr. N.M. Joshi, one of the founders of the A.I.T.U.C. and the nominated member representing labour interests in the Indian legislature, brought up this matter in the legislature through a resolution in March 1921. The Government of India, however, was not yet prepared to adopt legislation for this purpose. It was

only in 1925 that the authorities could be persuaded to draft a bill and present it to the legislature. This bill was passed in February 1926 as the Indian Trade Unions Act. It came into force on 1st June, 1927.

The Trade Unions Act provided for the legal registration of trade unions on a voluntary basis. Any seven or more members of a trade union could apply to the Registrar of trade unions of a Province to have their union registered. The application for registration had to give details about the rules of the union, particulars about the members submitting the application, the name and address of the trade union and the names, addresses and occupations of the office-bearers of the union. If the union was more than a year old, it had to furnish in addition a statement of its assets and liabilities. A trade union would be refused registration if its rules, as disclosed, did not provide for such matters as a statement of its objectives, the manner of admission of members and election of office-bearers, the purpose for which it would spend its funds and so on. Not less than half of the office-bearers of a registered trade union had to be persons actually engaged or employed in the industry with which the trade union was concerned. No person below the age of 15 could be admitted as a member of a registered trade union and no member could become an office-bearer unless he had attained the age of 18. All members were to have free access to the account books and list of members of their trade unions.

The funds of a registered trade union could not be spent for other than the following purposes: salaries, allowances and office expenses; prosecution or defence of legal proceedings of which the trade union was a party; conduct of trade disputes; compensation to members for loss arising out of trade disputes; sickness, accident and similar other benefits to members or their dependants; undertaking insurance liabilities on behalf of members; educational and social benefit schemes undertaken for members or their dependants; cost of publishing periodicals; and payment of contributions to other agencies working for any of the above objectives, provided that such contributions must not exceed in any particular year one-fourth of the total income that has accrued to the trade union up to that year. A trade union might constitute a separate fund for the promotion of the civic and political interests of its members, for example, defraying the election expenses of a candidate in an election, but contributions to this fund must remain voluntary. The rules of a trade union must provide for an annual audit of its accounts, the manner of such audit being prescribed by the government.

The fulfilment of these conditions would entitle a trade union to registration. A certificate of registration issued by the Registrar of Trade Unions in the Province conferred on the registered trade union certain privileges and immunities. No officer or member of a registered trade union would be held liable to penalties for conspiracy simply because he conspired against employers so long as he was associating with others for the

furtherance of the stated objectives of the trade union. He was also not liable to be sued in a civil court for damages simply because he was inducing workers to break their contracts of employment or interfering with the business of the employer. Even if individual members of a trade union committed an offence involving a breach of contract the trade union would not be liable for his action if it could be proved that the member in question acted without the knowledge of or contrary to the express instructions issued by the executive of the trade union.

The certificate of registration of a trade union could be withdrawn or cancelled by the Registrar, after giving two months' notice to the trade union concerned, if the trade union furnished false information or contravened the provisions of the Trade Union Act. If the application for registration was rejected or if notice was given of cancellation or withdrawal of registration the aggrieved trade union could appeal against the Registrar to Civil Courts with the appropriate jurisdiction.

A registered trade union was required under the Act to send annual returns to the Registrar relating to its incomes and expenditure as well as its assets and liabilities. The returns had also to contain all particulars relating to changes made in the trade union's rules and in its office-holders during the year. Fines for non-submission of such returns or penalties for wilfully deceiving a member of a trade union by supplying him false information regarding the rules of the trade union were laid down in the Trade Union Act

Registration under the Trade Union Act did not by itself make a trade union acceptable to employers. A trade union's status as an agent for bargaining on behalf of its members depended primarily on its membership, organisational strength and the presence or absence of rival trade unions in the same sphere of activities. Measures to provide for collective bargaining with one representative union among the workers in an industry have often been talked about. However, a formal procedure to assess the representative character of the bargaining trade Union still remains to be worked out in detail.

Labour Legislation and Labour Policy under the Five Year Plans

Several Laws aimed at the amelioration of working conditions for organised labour and giving them greater security were adopted by the Indian Parliament in the period after 1951. Among these are: Plantations Labour Act (1951), Employees' Provident Funds Act (1952), Mines Act (1952), Maternity Benefit Act (1961), Payment of Bonus Act (1965), Contract Labour (Regulation and Abolition) Act (1970), Bonded Labour System (Abolition) Act (1976) and several other measures. A number of welfare funds were created to provide amenities to workers in mines. To promote the policy of workers' participation in management, a new Article (Article 43–A) was

inserted in the Constitution of India under the Directive Principles of State Policy making such participation one of the cardinal principles of the country's labour policy.

The Plantations Labour Act (1951) was made applicable to all plantations under tea, coffee, cinchona and rubber provided that the plantation was at least 25 acres in size and employed not less than 30 workers. The Act made it obligatory on employers to provide certain essential amenities to workers in plantations, such as drinking water and latrines, and adequate medical facilities. A canteen was to be provided in all plantations employing 150 or more workers and a creche in all plantations employing 50 or more female workers. Hours of employment for adult workers were fixed at 54 per week with a maximum spread-over of 12 hours per day. For adolescents and children only a 40 hour week was permitted. Provision was also inscribed for a weekly holiday and a rest interval of half an hour after every 5 hours' work. Children below the age of 12 were not to be allowed to work in plantations. Night work (7 p.m. to 6 a.m.) for women and children was also made illegal. Annual leave for the plantation worker was also provided for, at the rate of one day for every 20 days' work for adults and one day for 15 days' work in the case of children or adolescents. In 1960 the Act was amended to check evasion of its provisions through splitting of size of existing plantations.

The Indian Mines Act (1952) was adopted to bring down the hours of work in mining operations to 48 per week. No worker was to work for more than 9 hours a day above ground and more than 8 hours a day in underground mines. The maximum spread-over of work was to be 12 hours a day above ground and 8 hours below. The rate of over-time pay was to be 1½ times the ordinary wage for workers above ground and twice the ordinary wage for workers below the surface. Workers were not to be allowed to work underground until the attainment of 18 years of age. For workers between the ages of 15 and 18 the maximum permissible period of work was to be 4½ hours per day. Underground work was prohibited for female workers, as well as work during the hours between 7 p.m. and 6 a.m. Provisions was also made in the Act for a weekly holiday and annual leave (for monthly paid employees, 14 days for 12 months' continuous service; for weekly paid employees, 7 days). Employers were required to provide such amenities as canteens, creches for children and rest-shelters.

The Employees' Provident Fund Act (1952) applied in the first instance to factories employing 50 or more workers in six industries, *viz.*, textiles, cement, cigarettes, iron and steel, paper and engineering goods. The scope was extended by subsequent amendments. Initially only workers earning less than Rs. 300 a month were covered, but later this limit was also raised. The objective of the Act was to set up a fund, to be administered by a Central Board of Trustees nominated by the Central Government, to which both employers and employees during their working lives were to make

regular contributions and which would be used to provide benefits to workers on their retirement from active employment. Initially the contribution from both employers and their employees was fixed at $6\frac{1}{4}$ per cent of an employee's total emoluments. This was subsequently raised to 8 per cent. An employee would be entitled to receive the full amount of his employer's contribution only if he had put in 15 years of service; for shorter service periods the amount received would shrink. But he was always entitled to get back his own contribution to the fund with appropriate interest. By 1980 the benefits of the Act had been extended to nearly 1 crore workers.

The Payment of Bonus Act (1965) was aimed at securing for employees a share in the profits of the concern where they were employed The Act was made applicable to all factories and establishments with 20 or more workers. The minimum annual bonus for an employee was to be 4 per cent of his salary or wages during the accounting year or Rs. 40, whichever was higher. This minimum amount was to be paid, irrespective of the level of profits. The maximum was fixed at 20 per cent of wages and dearness allowances. To be eligible for bonus payment a worker must have worked for at least 30 days during the year. For being eligible to the full amount of bonus, the worker must attend to his work during all the working days. On the recommendations of the Bonus Review Committee (1972) the minimum amount of bonus was raised to 8.33 per cent, which is equivalent to one month's salary subject to a minimum payment of Rs. 100. This amount could be regarded as 'deferred' wage, since it had to be paid irrespective of the profitability of the bonus-paying establishment. In respect of profit-earning concerns the Act laid down that 60 per cent of profits, as defined in the Act, was to be set aside for the payment of bonus to employees. However, employees with earnings above certain amounts, notified from time to time, were not eligible for bonus payments.

Finally, a brief reference may be made to the Bonded Labour System (Abolition) Act (1976). The system of semi-servile, even totally servile, labour was a feature of Indian rural life, particularly since the system of money-lending came to acquire importance during the British days. A person lending money to a landless rural worker could impose bondage (that is, unpaid or poorly paid labour service) on the borrower and his succeeding generations. Estimates of the numbers of such bonded labourers have varied between 3.5 lakhs and 22 lakhs, but returns received from State governments showed their number to be only 1.2 lakhs. Obviously these figures differ because of differences in the concept of 'bonded' labour. The Act of 1976 made illegal the system of holding labour in bondage and provided for the rehabilitation of such labourers at State expense.

The Government of India also initiated surveys of the working and living conditions of rural labour in 1950-51, 1956-57, 1963-65 and

1974–75.[3] Though these surveys yielded valuable data and helped in the construction of index numbers of wages for agricultural workers, they also revealed that the implementation of the Minimum Wages Act (1948) in respect of agricultural and other less organised workers had remained perfunctory. Weakness in State-level law-enforcing machinery, coupled with the slow growth of trade unions among rural workers, has served to maintain, and even widen, the disparities between their earnings and those of workers in organised industries.

3. The first two enquiries were limited to rural agricultural labour households.

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A History of Indian Currency and Exchange

In the early part of the nineteenth century the Indian currency situation was extremely confusing. The Mughal mints located in several places in the country issued both gold and silver coins which were intended to circulate at a fixed ratio. But the ratio of exchange between these different kinds of coins fluctuated according to the current demand and supply of bullion. In addition to the Mughal coins, there were others issued by princelings who had declared themselves independent or semi-independent: the right to issue coins under one's own seal was regarded as a mark of independence from suzerainty. No official measures could be adopted to keep all these various coins circulating in a fixed ratio with another. In this situation professional money-changers, who maintained stocks of all kinds of coins and were prepared to exchange one kind for another at a price, carried on a thriving business.

In 1806, after several experiments with bi-metallism, the silver Rupee was officially accepted by the East India Company as the standard coin. But Rupees of varying weights and fineness still continued to be minted in different parts of the country. The important currency measure of 1835 defined the Rupee as a silver coin of 180 grains (troy) 11/12 ths fine (*i.e.*, containing 165 grains of pure silver) and provided for the minting of only such coins in the official mints. There was no restriction on the minting of silver: any one tendering silver could get from the mint an equivalent number of Rupee coins by paying a small charge for the coinage.

The declaration of the silver Rupee as the only official currency meant in effect that gold was demonetised. The prevailing gold coins, however, still passed from hand to hand. Even government treasuries were prepared to receive them in discharge of public obligations, but they were not issued back into circulation. After January 1, 1853, gold coins were declared as unacceptable to public treasuries as the price of gold was continually falling at that time because of the great gold discoveries in Australia and the U.S.A. The amount of circulating media was thus considerably reduced at a time when internal and external commerce were both expanding. To relieve the current monetary stringency three proposals were mainly canvassed, *viz.*, (1) to introduce gold coins circulating in a fixed ratio with the silver Rupee (the bimetallic system), (2) to encourage the use of paper

notes by direct government issue of such notes instead of leaving the business of note-issue to banks, and (3) to develop the system of commercial banking to a fuller extent so as to obviate the need for both coins and notes. Mr. Charles Wilson, the first Finance Member of the Governor-General's Executive Council constituted after the Mutiny, preferred the second alternative and wanted to base the paper currency on the proportional reserve system which was expected to impart greater flexibility to the note issue than the fixed fiduciary system on which the English paper currency had been based in 1844. Mr. Wilson, however, died before the reforms came into effect. His successor, Mr. Samuel Laing, changed the basis of the note issue by adopting the fixed fiduciary system. The fiduciary limit was fixed at Rs. 4 crores, the rest of the paper currency being fully backed by silver or gold bullion. Since gold was no longer in use as currency, the maximum limit for the use of gold in the metallic reserve was laid down as 25 per cent of such reserve.

Both Mr. Laing and his immediate successor, Sir Charles Trevelyan, continued to be pressed by paucity of currency in circulation and Trevelyan, in particular, sought to relieve this stringency by permitting gold Sovereigns minted in England and Australia to circulate in India as legal tender coins at the fixed rate of £1 = Rs. 10. The Secretary of State for India was, however, opposed to the bi-metallic system and rejected the proposal for making gold Sovereigns legal tender. Gold coins, however, became acceptable once again in payment of Government dues and paper notes could be issued in exchange for gold coins held in the metallic reserve. These concessions were made into law by two Notifications in 1864. Subsequently, as a result of a slight fall in the market value of silver, gold became undervalued at the current rate. On the recommendation of the Mansfield Commission set up in 1866 the gold Sovereign was slightly revalued and the revised parity was declared as £1 = Rs. 10.5. But as silver prices continued to fall, the bi-metallic arrangements were finally given up in May 1874.

The fall in silver prices that began in 1873 continued for several years, mainly due to over-production in the world's silver mines. There had been a marked decline in the demand for silver as most West European countries definitely cast off silver from their currency system and adopted gold as the single monetary standard. The price of silver fell from about 60d. per ounce in 1872 to 29d. per ounce in 1894. As silver lost its value in relation to gold, the silver Rupee began to depreciate in terms of the Pound Sterling which was based on gold. The Rupee which was equivalent in 1872 to 1s. 10.7d. was reduced in value to about 1s. 2.5d. in 1894.

The continued fall in the value of silver, and consequently in the sterling value of the silver Rupee, created a lot of difficulties for the government and the trading public. Every fall in the value of the Rupee meant that the Government of India had to find a larger number of Rupees to make the

same sterling payment. As the 'Home Charges' were sterling obligations, their Rupee burden increased and additional taxation became necessary to meet this added burden. Besides as nobody could predict the exact course of the fall in silver prices, the Government's budgetary estimates became subject to uncertainties. As it used to be said at the time, the budget became a 'gamble' in the exchanges.

British officials, seeking to remit money from India to England, found the value of their salaries, received in Rupees, continually declining and clamoured for compensation to meet such unforeseen losses. For British goods higher Rupee prices had now to be paid and this discouraged imports of machinery. British investors were discouraged by the fact that profits made in India were losing their value in relation to sterling. At the same time, export prices expressed in sterling were lower and exports were likely to be encouraged. It is doubtful, however, whether the supply of exports was elastic enough to enable Indian exporters to sell more at the lower prices.

To arrest the fall in the value of silver, proposals to adopt bi-metallism on an international basis were often discussed. But after the International Monetary Conference held at Brussels in 1892 failed to throw up a generally acceptable solution, all hopes of a restoration of the value of silver were given up.

Since silver was fast losing its value, the issue of adopting gold as the monetary standard once again became a live issue in India. On the initiative of Sir David Barbour, then Finance Member, the Government of India addressed on August 2, 1892, a despatch to the Secretary of State seeking permission to adopt gold as the monetary standard. It was proposed in this despatch to stop the free coinage of silver and to open the mints to the free coinage of gold. In October 1892 these proposals were referred by the Secretary of State to a Committee presided over by Lord Herschell. In their Report the Committee recommended that though the free coinage of silver should be suspended, the Government should continue to have silver coined in response to demand or in exchange for Sovereigns at a rate of £1 = Rs. 15 (*i.e.*, Re. 1 = 1s.4d.). The recommendations of the Herschell Committee were given effect to by three Notifications issued on June 26, 1893. By the first, the Government undertook to give rupees in exchange for gold at 7.53344 grains (fine) for a Rupee, but not gold for Rupees. The second made Sovereigns receivable at public treasuries at the same rate (which was equivalent to £1 = Rs. 15). The third Notification authorised the issue of paper notes against a reserve in gold or Sovereigns. The Herschell Committee expressed the hope that by introducing these measures the way would be opened for the eventual opening of the mints to the free coinage of gold.

In the years preceding the closing of the mints to silver in 1893 there had been a heavy coinage of silver. Suddenly the brakes were applied.

The supply of silver rupees fell and the rupee-sterling exchange rose. A contributory factor in the rise of the Rupee exchange was the recovery in general world prices after 1896.

In 1898 the Government of India submitted another set of proposals for the establishment of a gold standard in India with a gold coin as the principal circulating medium. The proposals were once again referred to a Committee under the presidentship of Sir Henry Fowler. The Committee agreed to the eventual establishment of a gold standard in India with a gold currency whose volume would vary according to the free inflow and outflow of gold. With this end in view they recommended the continuance of the existing policy regarding the closure of mints to silver. The mints, they recommended, should be opened as early as possible to the free coinage of gold. Pending final arrangements regarding this, the gold Sovereign, they felt, should be declared as unlimited legal tender in India at the already accepted rate, *viz.*, £1=Rs. 15. The Government of India was not required at this stage to accept an unlimited liability of giving gold for rupees, but if gold was needed for purposes of external remittance, as indicated by the value of the Rupee falling below the lower 'specie' point, the Government was to make gold available for such purposes. To obtain the gold necessary for meeting this obligation the Government of India was advised to set up a Gold Reserve by buying gold and sterling securities with the profits of rupee coinage.[1] Since the ultimate object was to reduce the importance of silver in the coinage, fresh silver rupees were not to be coined until the proportion of gold in the currency was found to exceed the requirements of the public..

The Government of India put into effect all the recommendations of the Fowler Committee except the one relating to the establishment of gold mints in India. The result was the establishment of a gold standard without a gold currency, gold being made available only for purposes of foreign remittance. This type of currency arrangement came to be known as the Gold Exchange Standard. In practice, since the bulk of Indian remittances was to England, the system operated as a sterling exchange standard.

The Gold Exchange Standard enabled the country to have the benefits of a stable foreign exchange rate with other gold standard countries without having to maintain a large gold reserve for maintaining the convertibility of domestic currency into gold. Normally Indian remittances to England could be financed out of the proceeds of India's commodity export surplus, so that transfer of gold would be unnecessary. It was only in years of abnormally low exports that the gold reserve would be called upon to provide the needed funds. Thus a comparatively small gold reserve would suffice to keep the system in operation. Moreover, the reserves could con-

1. Since the Rupee was now a 'token' coin, its value was greater than the cost of silver it contained.

veniently be located in an important foreign financial centre and could earn some interest on being invested there. A gold reserve located in the home country would have been completely sterile. In emergencies the assets in the reserve could be speedily disposed of in the foreign financial centre and foreign creditors easily satisfied. Thus the gold exchange standard came to be looked upon as a system well suited to the needs of a debtor country like India.

Since the Government of India had bound itself to give 15 rupees for £1, the sterling value of the Rupee could not rise above this rate (Re. 1 = 1s.4d.) by more than the cost of sending out gold Sovereigns to India. In other words, the upper limit to the sterling value of a rupee would be, say, 1s.4⅛d. To prevent the rupee from falling much below its accepted official value, the Government undertook to sell sterling bills in unlimited amounts in return for rupees tendered in India. These bills would be drawn on the Secretary of State in London who would give for them sterling at a rate not below 1s.3$\frac{29}{32}$d. Thus the sterling value of the rupee would be prevented from falling below this lower limit.

The operation of this system was facilitated by the fact that remittances from India to the Secretary of State in England had to be regularly arranged. This gradually took the form of periodical sales in England of Council Bills and telegraphic transfers on India. Traders in England who owed funds to India could discharge their obligations by the purchase of such bills or transfers, while the Secretary of State obtained funds by drawing bills on the Government of India. Up to 1893 the volume of sales of Council Bills was limited to the actual requirements of the Secretary of State. But subsequently the amount of sales was enhanced to meet the requirements of the trade, so that it was no longer necessary to effect transfer of gold in payment of obligations to India. Part of the funds raised in this way was used to purchase silver for shipment to India, this silver being then used to mint additional silver rupees. Another part was credited to the Paper Currency Reserve against which additional paper notes would be issued by the Government of India. However, pending the manufacture and issue of these additional coins and notes the Government of India could meet the bills drawn by withdrawing funds from its various balances in India. "These balances were divided between some 270 district treasuries and 1,500 sub-treasuries, 36 branches of the Presidency banks, the three head offices of these banks at Calcutta, Bombay and Madras and the Reserve treasuries at the last three places."[2]

A working balance of over £4 million also used to be maintained by the Secretary of State, which would be available to meet any bills drawn by the Government of India on the Secretary of State. Such bills, called Reverse Councils, would be sold to prevent the value of the Rupee from falling

2. Sapre, B.G., *Essentials of Indian Economics*, pp. 344–45.

below a certain limit. Nearly half a million pound of these balances would be kept on deposit with the Bank of England. The rest would be lent out to approved borrowers for short periods. Some interest was thus earned on these balances. But maintaining a large balance in U.K. obviously implied that such funds were available for English borrowers at the cost of Indians who consequently had to pay higher rates on their borrowing in the Indian market.

Sale of Reverse Councils was resorted to in 1907–08 when the exchange value of the Rupee was sagging owing to a fall in the value of Indian exports. Weekly sales of Reverse Councils were made during the period March–September 1908 at the rate of 1s. $3\frac{29}{32}$d. per rupee. In all £8 million worth of Reverse Councils were sold, the Gold Standard Reserve[3] being depleted to that extent.

The Chamberlain Commission was set up in 1913 to review the existing currency and exchange practices and to pronounce on the advisability of having a gold standard with a gold currency. The Commission (which included John Maynard Keynes, later Lord Keynes, as a member) considered the Gold Exchange Standard as eminently suitable for India and regarded the full Gold Standard as too expensive and uncalled for in the Indian context. They made certain recommendations to improve the working of the system. On their advice the Gold Standard Reserve, instead of being entirely invested in London, came to be held in actual gold to the extent of at least 50 per cent. The portion invested also came to be held in more easily realisable securities, as the crisis of 1907–08 had shown that during an emergency difficulties could arise in obtaining liquid funds by selling securities.

The Government paper currency in India dates from 1862 when the previously existing notes issued by the Presidency Banks were withdrawn from circulation. Government notes were issued in various denominations ranging from Rs. 10 to Rs. 10,000. The five-rupee note was first issued in 1891. Initially the notes of higher denomination were encashable only within the circle in which they were issued, but later they were made encashable in any part of the country. The system of note issue followed the British system; the 'fiduciary' limit was initially fixed at Rs. 4 crores, but was raised successively to Rs. 14 crores by 1914. The amount of sterling securities to be held in the Paper Currency Reserve was not to exceed Rs. 4 crores.

3. The Gold Standard Reserve was built out of the profits of Rupee coinage. The original idea was to keep this reserve in gold and in India. But later it was argued that since the gold in the reserve would in any case be remitted to England, the Reserve should be located in London and invested in securities. In 1906 a part of this reserve came to be held in India in coined Rupees. As the reserve swelled and occasions for using it were rare, a Committee in 1907 advised that 50 per cent of the profits on rupee coinage be diverted for capital expenditure on railways.

Though the primary objective of the Paper Currency Reserve was to secure the convertibility of the paper notes, this Reserve also came to be of use from the point of view of exchange management. Against gold tendered in London and credited to the Paper Currency Reserve (London branch) paper currency was issued in India. In 1905 £5 million worth of Sovereigns were shipped from India to London to be kept there as part of the Paper Currency Reserve. The avowed intention was to save the time in shipping gold for purchase of silver. If the gold was located in London, it could be readily used whenever there was a keen demand for rupees in India and the Government was called to mint additional silver rupees to meet this demand.

During the First World War there was generally a steady demand for Indian exports while imports contracted. Moreover, remittances had to be made to India from England to meet the war expenditure in the eastern theatres of war. The British liability to India could not be discharged through remittance of bullion, since various restrictions had been put in England on exports of gold. The supply of silver was declining in India, while demand for currency purposes went up. There were intervening periods of weak exchange when Reverse Councils had to be sold,[4] *e.g.*, between August 1914 and January 1915, in 1915-16, and again between November 1918 and April 1919. But it was more usual for the Government of India to face a heavy demand for encashment of Council Bills which caused an enormous expansion of currency. The Government had to enter the silver market as a purchaser on a large scale, particularly during 1916–19. Between April 1916 and March 1919 over 300 million standard ounces of silver were bought for coinage in addition to two million ounces purchased from America under the Pittman Act, as compared with about 180 standard ounces between April 1904 and March 1907.

The price of silver soared as a consequence. In 1915 the highest price of silver in the London market was 27¼d. per standard ounce. By April 1916 this rose to 35⅛d. and in December the price rose to 37d. In August 1917 it reached 43d. The United States, the chief source of silver exports, imposed various restrictions which kept silver prices more or less steady between 40d. and 50d. per ounce over the period October 1917–April 1919. When in May 1919 the restriction on the silver market were withdrawn the price of silver in London reached 58d. and by December 1919, on account of exceptionally heavy demand coming from China, the price rose to 78d. per oz. Another factor behind the rise in the sterling price of silver was the depreciation of sterling in relation to the dollar. In December 1919, sterling had fallen to 3.83 dollars while its par value was 4.866 dollars.

The face value of the silver rupee fell below the value of its silver content as soon as silver prices reached 43d. an ounce. It was no longer possible

4. Sales of Reverse Councils aggregated £19 million during 1914–19.

for the Secretary of State to sell Council Bills on India at 1s. 4⅛d. without involving the Government of India in losses on the resultant expansion in silver coinage. Moreover, it became lucrative to melt silver rupees and sell them as bullion. After August, 1917, the exchange value of the Rupee rose in successive steps, mainly in sympathy with the rising price of silver. From 1s.5d. on 28th August, 1917, the Rupee rose to 2s.4d. on 12th December, 1919.

During the War the Government of India had adopted a number of measures to cope with the changes in the currency and exchange situation. First, in view of the difficulties of coining rupees, the offer of unlimited sale of Council Bills was withdrawn with effect from 20th December, 1916. Only limited amounts were sold at rates varying from time to time according to the prevailing situation.[5] Secondly, export of silver coin and bullion from India was prohibited by an order of 3rd September, 1917. Melting coins was made an offence. Paper notes in denominations of Rs. 2½ and Re. 1 were issued for the first time. Nickel coins for 8 as., 4 as., and 2 as. were introduced to reduce the use of silver in the coinage. Thirdly, increased currency needs were sought to be met by minting in Bombay more than 2 million gold *mohurs* and 14 million gold Sovereigns. A part of the gold required was obtained by purchase from the U.S.A. and Canada. Fourthly, the circulation of paper notes was expanded. Gross paper currency issue went up from Rs. 66.12 crores on March 31,1914 to Rs. 153.46 crores on March 31 five years later. The maximum fiduciary issue, Rs. 14 crores before the War, was first raised in November 1915 and revised further upwards on nine occasions until in November 1919 it stood at Rs. 120 crores.

The Babington Smith Committee appointed to advise the government on the proper rate of stabilisation of the Rupee in the post-war years anticipated that the rise in silver prices had come to stay. They recommended, therefore, that the Rupee should be stabilised at the new rate of Re. 1 2s. in terms of gold. As sterling had depreciated in relation to gold during the war years, 2s. gold meant 2s. 4d. in terms of post-war sterling. The Committee felt it advisable to link the Rupee directly to gold rather than to sterling which was itself depreciating.

The recommendations of the Babington Smith Committee which reported in February 1920 were immediately accepted. The Rupee was statutorily declared equivalent to 2s. gold and Sovereigns were declared legal tender at Rs. 10 each. It soon became clear however, that the Committee had taken a very short-term view. The post-war trading boom soon spent its force. Both the Bank of England and the Federal Reserve System in the

5. When restrictions on gold exports were removed by England in July 1919, an alternative method of remittance became available and measures of control relating to sale of Council Bills lost their effectiveness.

U.S.A. went in for policies of deflation in their respective countries. The British Bank Rate was raised to 6 per cent in November 1919 and to 7 per cent in April 1920. World prices, as measured by the *Statist* index, fell from 295 in 1920 to 182 in 1921. The consequence of all this was a decline in the value of Indian exports. From Rs. 330 crores in 1919-20 exports fell to Rs. 258 crores in 1920-21. Over the same period imports went up from Rs. 208 crores to Rs. 336 crores. In face of the pressure for foreign payments, it became difficult to sustain the value of the Rupee at 2s. gold (which at this time meant nearly 3s. sterling). The European community in India seized the opportunity offered by the higher exchange value of the Rupee to make large remittances of their profits to England. For some time the government sold Reverse Councils in an attempt to hold on to the declared exchange rate, the rates varying between 2s.$3\frac{25}{32}$d. and 2s. $10\frac{27}{32}$d. sterling. Again, when such high rates proved difficult to maintain, the government for some time struggled to stabilise the Rupee at 2s. sterling. The aggregate amount of Reverse Councils sold in this vain attempt at stabilization amounted to £55.53 million. As sterling balances dwindled, the effort was given up and in the early months of 1921 the rupee fell below 1s.3d. sterling (or 1s. gold).

As a preliminary to the restoration of exchange stability, the government decided to put its finances in order. By 1923-24 it proved successful in presenting a balanced budget and reducing the floating debt. This created conditions for the contraction of currency. During 1920-23 currency was contracted by Rs. 38 crores. In 1924 the Imperial Bank's discount rate was raised to 9 per cent. During this entire period sales of Council Bills remained suspended, the Secretary of State obtaining funds by recovering dues from the British Government and by loans.

The effect of all these measures was a recovery in the exchange ratio. In September 1924 it was about 1s.$5\frac{3}{4}$d. and in October 1s.$6\frac{5}{16}$d. (= 1s.$4\frac{3}{4}$d. in gold). By mutual consultation between the Government of India and the Secretary of State it was decided that, "without making any public announcement of policy, efforts should be made to prevent exchange from breaking away materially above 1s. 6d. ...any tendency of exchange to rise appreciably above this figure being counteracted by free offerings of Rupees."[6] Accordingly in the latter part of 1924-25 remittances from India to the Secretary of State began to be made by purchase of sterling in India. Sales of Council Bills in London were also resumed at rates varying between 1s.$5\frac{13}{16}$d. and 1s.$6\frac{5}{32}$d. per rupee

When sterling was re-linked with gold at the pre-war parity in mid-1925, the government considered it desirable to have the entire currency situation comprehensively reviewed once again. The Hilton Young Commission was set up in August 1925 to carry out this review. After examining

6. Report of the Hilton Young Commission, Appendix 69.

various alternatives, the Commission decided in favour of a Gold Bullion Standard as the future monetary system for India. The ordinary medium of circulation was to remain unchanged in the form of the silver rupee and the currency note. But stability of the currency in terms of gold would be secured by making the currency directly convertible into gold for all purposes. This would secure public confidence by linking the currency with gold "in a manner that is real and conspicuously visible." The currency authority was to buy and sell gold without limit at rates determined with reference to a fixed gold parity, but in quantities of not less than 400 fine ounces, no limitation being imposed as to the purposes for which gold was required. The limitation relating to quantity was intended to prevent gold from being frittered away internally. To bring home to the people that the currency was in fact based on gold the Commission proposed the issue of Savings Certificates "redeemable in 3 or 5 years in legal tender money or in gold at the option of the holder." To reduce the importance of the silver rupee the Commission recommended the re-introduction of the one-rupee notes. No new rupee coins should be coined and gradually rupee coinage was to shrink and be eventually redeemed in gold.

The Gold Bullion Standard was generally regarded as superior to the pre-war Gold Exchange Standard since it provided for automatic expansion and contraction of domestic currency in response to movements of gold into and out of the country. But bitter controversy arose regarding the new rupee-sterling ratio recommended by the Hilton Young Commission. While Indian business interests very much wanted to go back to the pre-war sterling parity of Re. 1 - 1s.4d., the Commission gave its verdict in favour of a higher value for the Rupee, *viz.*, Re. 1 - 1s.6d. It was pointed out by the majority of the Commission that the higher parity recommended was simply in recognition of the rate which had come to be established by automatic forces in the foreign exchange market and had remained practically unchanged for several months before it was taken up for stabilisation. Indian public opinion accused the government of artificially jacking up the foreign exchange rate by internal deflation and pointed out that the higher rate was bound to injure the interest of agricultural exporters in India, while giving a stimulus to the sale of manufactured British goods in the Indian market.

When Britain left the Gold Standard in September 1931 the Government of India also abandoned the gold links of the rupee and began to deal only in sterling to keep the rupee-sterling rate at Re. 1 - 1s.6d. The currency standard in India became a purely Sterling Exchange standard. The currency measures adopted during 1931–32 left the Indian price of gold at a lower level than its British price. Consequently much of the gold parted with by the distressed agriculturists of India during the Depression found its way to the London gold market. In a way these gold exports from India enabled her to tide over a period of adverse balance of payments ushered

in by the severe falling off in agricultural export prices. But the country's gold stock was depleted by nearly 36 million ounces during 1931–37, the value of the gold exports being put at more than Rs. 300 crores.

During the Second World War the link between the rupee and sterling could be utilised by the British Government to pay for its rupee expenses by handing over sterling securities to the Government of India's account at the Bank of England. By agreement between the two governments these sterling balances accruing to the Government of India were to remain blocked during the war and even after the war ended they were to be released in instalments so as not to upset the British balance of payments. These blocked sterling balances were transferred by the Government of India to the Reserve Bank which used them as security for the issue of additional Rupee currency in India. By December 1946 the total volume of sterling securities held in the Reserve Bank of India's Issue Department had risen to Rs. 1135.32 crores and balances held abroad by the Banking Department of the Bank reached a figure of Rs. 485.76 crores. Because of the very favourable trade balance enjoyed by India during the war years the Reserve Bank had to purchase more sterling than it sold and this also led to the accumulation of sterling in the Reserve Bank.

The domestic counterpart of the accumulation of sterling was the expansion of currency and the rise in prices during and after the war. The Reserve Bank's note issue (including notes held in the Banking Department) rose from Rs. 210.64 crores in 1938-39 to Rs. 1253.86 crores in 1948–49. The general index of wholesale prices (base. August 1939) rose to 220.1 in March 1943 and to 307 in March 1948. In June 1950 the index stood at 395.6. The index was not entirely satisfactory: many commodities were entered in the index at controlled prices which were no longer operative. While the war inflation was to some extent subdued owing to non-availability of desired goods and war-time control measures, the post-war inflation was aggravated by the spending of accumulated balances and the hasty annulment of control measures. Moreover, immediately after August 1947 political and industrial unrest brought about a decline in levels of production. The new Government of India had to run into budget deficits in order to meet the expenditures on refugee rehabilitation and essential post-war reconstruction. Inflation continued to pose a serious threat to the economy at the time of adoption of the Five-Year Plans in March 1951.

A Critical Estimate of Indian Currency and Exchange Policy Under British Rule

The currency and exchange policy followed by the British rulers, although endorsed by several Committees and Commissions composed of eminent economists and financiers, was not regarded by Indian public opinion as conducive to this country's economic interests. The Gold Exchange Stan-

dard, as it evolved during the closing years of the nineteenth and the early years of the twentieth century, mystified Indian opinion to such an extent that it was often believed to be the root cause of all economic ills from which India suffered. The principles of the Gold Exchange Standard were not clearly expounded before the First World War and the system grew up by bits and pieces. One consequence of this was to create in the minds of Indians a certain amount of misgiving regarding the aims and methods of operation of the monetary authorities. The Gold Exchange Standard came to be looked upon with disfavour mainly on the following grounds:

(*a*) It was a complicated system by all appearances. Unlike the Gold Standard which worked on the basis of free circulation and unimpeded inflow or outflow of gold, the Gold Exchange Standard rested on a system of reserves whose functions were not properly understood in the early days. This helped to aggravate misgiving. The gold in the reserves was transferred, on one pretext or another, to England so that this country had to be satisfied with a currency system which neither maintained a visible link with gold nor used a full-valued coin made of silver.

(*b*) The Gold Exchange Standard meant in effect that India's foreign exchange reserves were loaned to the British money market. Although this enabled the monetary authorities in India to earn a certain income in the form of interest, the alienation of the reserves could be the cause of stringency in the Indian money market. The system thus operated with a definite deflationary bias at a time when Indian economic agents might be galvanized into action by the stimulus of a profit inflation.

(*c*) On those rare occasions when India ran into a deficit in her balance of payments the system worked in a faltering manner since reserves were maintained, at least before 1913, in only a semi-liquid form. The guarantee against default which a large gold reserve could have given was not provided by the Gold Exchange Standard system which was thus a poor substitute for a full-fledged Gold Standard.

(*d*) The system could work only so long as India's trade surplus (or deficit) remained within moderate limits and the price of silver in the token Rupee remained in a certain relation to gold. As soon as any of the above conditions gave way, the working of the Gold Exchange Standard got disrupted. This was the reason why the currency arrangements of 1898–1917 came to be characterised as a 'fair weather' system.

The economic relations between India and Britain very naturally led the British rulers to prefer a higher sterling value for the Rupee after the First World War. The attempt to maintain the value of the Rupee at 2s. gold in 1920–21 caused large losses of hard-earned sterling in the immediate post-war period. The 'ratio controversy' which followed the publication of the Hilton Young Commission's Report turned essentially on the question whether the British exporters' or the Indian exporters' interests

would be given greater priority. The plethora of arguments developed at that time in favour of either the 1s.4d. or the 1s.6d. ratio rested on dubious statistical data and could not be conclusive one way or the other. Even if the higher parity of the Rupee was justified during 1926–28, the depressing economic events of 1929–33 undoubtedly called for a downward revision in the Rupee parity. Instead the Government of India relied on a huge outflow of gold from the country to see them through the balance of payments crisis, proving once again that the foreign rulers were not in the least interested in constructing a viable currency and exchange system for India.

The Second World War thoroughly exposed the hollowness of the British claim that the Rupee's link with sterling was a source of strength to the former. In fact, the link with sterling brought about a large expansion of the currency in India on a very narrow base of gold. Since a very large part of the country's foreign exchange reserves remained 'blocked' during the War, the balance of payments surplus could not be turned to use to strengthen the productive capacity of the economy. By putting the Rupee-sterling link to their own use the British rulers had compelled India to make a huge loan of over Rs. 1,600 crores to Britain for the duration of the War. Once again the Indian monetary authorities earned some interest on this loan, but only at the cost of a disruption of the entire economic system in the inflation fed by the sterling balances.

It is thus clear that the currency and exchange policy pursued in India by the British rulers was not intended to provide India with a reasonably elastic monetary system maintaining over the years a stable standard of domestic values. The primary aim was to facilitate Indo-British payments which in most years meant British payments to India. Whenever possible the full discharge of British liabilities to India was deferred by taking advantage of the prevailing currency arrangements. Even if this led to untoward consequences for India's domestic economy the British authorities could usually find arguments purporting to show that the existing currency system conferred on India greater short-term benefits (*e.g.*, an income from the interest on British securities) than any alternative system. But not very much could be claimed about the relation of the prevailing currency and exchange system to the country's long-term interests.

Currency Experience Since Independence: The Devaluation of 1949

After the termination of hostilities in the Second World War, an international monetary system, based on the Bretton Woods Agreement, came into being and the Indian currency and exchange system was linked to this internationally approved system. The par value of the Rupee, which had to be expressed in gold under the rules of the International Monetary Fund, came to be accepted as 1 Re = 0.268601 grammes of fine gold. The sterling

value of the Rupee, as calculated from the gold parity of sterling, remained at 1 Re.= 1s.6d., but the Reserve Bank of India was no longer under any special obligation to maintain the rupee-sterling ratio. It could now conduct its dealings in any foreign currency; its only obligation was to keep the gold parity of the Rupee unchanged. At the same time the Rupee currency was to rest not simply upon sterling securities as hitherto. Other foreign securities could also be included in the currency reserve. The dependence of the Rupee on sterling thus came to an end and the Rupee emerged as an independent currency with its own gold parity.

In spite of this de-linking of the Rupee from sterling, when Britain devalued the sterling in September 1949, India had to follow suit. The gold parity of the Rupee fell to 1 Re.=0.186210 grammes. The devaluation left the sterling value of the Rupee unchanged at 1s.6d. while the Rupee's dollar value fell from 30.23 cents to 21 cents. Since India's main trading links were still with sterling area countries, a failure to devalue the Rupee by at least as much as sterling would have injured the interests of Indian exporters. At the same time, in the post-war period India was becoming more and more dependent on the dollar area for imports and the lower value of the Rupee in terms of the dollar raised the cost of essential imports and gave a further turn to the inflationary spiral already at work in India. After devaluation India's trade with Pakistan was almost completely disrupted owing to the latter country's decision to stick to the old parity.

The immediate impact of the devaluation on the Indian trade balance was not unsatisfactory. Between October 1949 and June 1950 the balance of trade improved by Rs. 172 crores. This improvement, however, was also partly the outcome of stringent measures of import control and of adventitious factors like the Korean War which suddenly raised the demand for some Indian export goods. The improved trade balance was accompanied by a fresh spurt in domestic currency circulation and prices. The index of wholesale prices which stood at 389.3 immediately before the devaluation (base: August 1939=100) went up to 405.2 in July 1950. The Government of India tried to contain the inflationary pressures with an 'eight-point programme' announced in October 1949. Export duties were introduced to soak up the extra earnings of exporters and schemes for price control and regulation of speculative dealings were taken in hand. Severe cuts were imposed on government expenditure, especially on Central development grants to the States. In spite of this fiscal support, the monetary authorities could hardly claim that the back of the inflation had been broken. In fact, a monetary policy suited to the twin tasks of promoting economic development and maintaining reasonable price stability was not easy to evolve in India's circumstances. But when the Five Year Plans came to be introduced in 1951–52, the search for such a policy came to be regarded as of paramount significance, and monetary institutions were expected to play a very crucial role in the coming era of economic development.

Rupee Devaluation of 1966

The foreign exchange situation in India turned critical around 1957–58 during the early stage of implementation of the Second Five Year Plan. The strategy of heavy industry development called for substantial stepping up of machinery imports. Although the imports of consumer goods and capital goods with domestic substitutes were strictly curtailed, the country was not in a position to meet her import bill out of the export proceeds. Inevitably recourse to foreign capital inflows had to be arranged for. At the same time, there were attempts to boost exports by giving various concessions to exporters, such as tax concessions on the profits earned from export sales, cash subsidies and permits for imports that could be sold in the domestic market for a profit. These 'import entitlements', as they were called, gave rise to a secondary market in such import permits and were partly responsible for the generation of 'black' money in the country. The basic objection against the entire system of export and import regulations was that a lot of discretionary power was conferred on the controlling authorities and free competition in the market for imported goods virtually disappeared. There were also delays in disposing of applications for import licences and consequent losses. In these circumstances it was decided that resort should be had to a substantial devaluation of the Rupee, so that exports could compete in foreign markets without the artificial support so long made available by the government and imports could also be curtailed to some extent through substitution of available domestic products. The International Monetary Fund and the World Bank both insisted that such a devaluation was a pre-requisite for the restoration of foreign capital inflow into India which had been interrupted by the outbreak of the Indo-Pakistan conflict in 1965.

The devaluation was announced on June 6, 1966. The extent of devaluation was 36.5 per cent on the existing parity,[7] which implied that the value of 10 grams of gold rose in terms of the Rupee from Rs. 53.58 to Rs. 84.39. The incidence of foreign debts in terms of the Rupee went up as a consequence. The rise in import prices gave a boost to inflationary forces working inside the country. The devaluation was, in fact, rendered partly ineffective by the post devaluation price increases. In the short run there was some improvement in respect of the trade balance, but before long the situation again called for special policy measures to increase exports, such as cash subsidies and import replenishment licences.

The devaluation, however, facilitated a larger inflow of foreign capital assistance. Both the international financial institutions and the Western industrial nations stepped up their loan assistance to India in the post-devaluation period. The preparation of Five Year Plans in India had to

7. The gold parity of the Rupee was reduced from 0.187 grammes to 0.118 grammes. The value of gold in terms of Rupees rose by 57.5 per cent.

remain suspended during 1966-69 because of the uncertainties concerning the balance of payments and the amount of foreign support likely to be available for meeting the gap in the current balance of payments. The devaluation created a better climate for external borrowing and thus enabled India to resume the activities involved in drawing up Five Year Plans. After carrying on with only a series of Annual Plans during 1966-69, the Planning Commission decided to resume working with plans for a longer period, *viz*., five years, as in the period 1951-66. Accordingly, the Fourth Five Year Plan came to be officially launched with effect from April 1, 1969.

18

Development of Modern Banking in India

"It is not improbable," remarked Cooke in his book on Banking in India, "that long before England had ranked in the scale of nations, India had adopted a system of banking which may have originated that now in use with the *shroffs* or native bankers." The antiquity of Indian banking can be established by references to bankers and bank documents in the *Arthashastra* of Kautilya and laws of Manu. During the period of Mughal rule bankers and financiers were held in high esteem; the financial stability of the Royal Court appeared to rest on the principal bankers of the country.[1] Banking activities were usually the monopoly of a few castes who were known by different names in different parts of the country.

The European trading companies in India at one time made frequent use of the services of India's indigenous bankers. The bullion which was imported by the companies was usually sold (at a discount) to the Royal bankers who often enjoyed a monopsony in respect of bullion purchases. For their purchases in India the companies had sometimes to resort to borrowing from the native bankers at rates usually varying between 9 and 12 per cent per annum. The banking houses were found useful by the East India Company for remitting its revenues from one part of the country to another and getting different types of currencies then circulating in the country exchanged for one another.

By the second half of the eighteenth century European Agency Houses began to come into existence. Usually founded with the accumulated capital of retired English traders and officials, these houses rendered a number of financial services for which the help of native bankers had to be sought in an earlier period. The rise of these European houses hastened the process of disintegration of native banking establishments which were already suffering from the disappearance of the royal patronage and the new system of revenue administration introduced by the Britishers in this country.

1. At the court of the Nawab of Bengal in the eighteenth century the Royal bankers (*Jagat Seths* as they were called) exercised tremendous influence and discharged useful banking functions. One of their functions was to stand as surety, for a consideration, on behalf of zamindars who were unable to pay the instalments of land revenue in time.

Under the auspices of one of these Agency Houses, Messrs. Alexander and Company, the first European bank in India, the Bank of Hindustan, started business in Calcutta in 1770. It continued in business until 1832 when the Agency House which founded it went out of business. In 1773 there was set up under Government patronage a General Bank which was entrusted with the responsibility of developing banking facilities in all Presidency towns (Bombay, Calcutta and Madras) and in the districts. But the Bank fell far short of its aims and was wound up in 1775. The next experimental bank, also in Calcutta, was the Bengal Bank (1784). It issued paper notes of its own and is also credited with an attempt to introduce the use of cheques The Bengal Bank did not have any link with an Agency House. It remained in business until 1791.

Banking on the joint-stock principle and with limited liability of shareholders was first seen in 1786. The second General Bank of India which started its operations that year was also a note-issuing bank. Its services were availed of by the Government of the day, while it could look to the Government for help in distress. But it could not survive the difficulties created by the Anglo-Maratha War in 1791 and had to close down in that year.

Towards the end of the eighteenth century a new bank called the Bank of Calcutta came into existence. It changed its name to Bank of Bengal in 1806. The East India Company subscribed Rs. 10 lakhs to its capital funds which amounted to Rs. 50 lakhs in all. Enjoying the Company's patronage this Bank soon became the most important bank in the whole of India and was entrusted with the safe custody of Government funds. Notes issued by no other bank were acceptable to the Government. It functioned on the basis of a $33\frac{1}{3}$ per cent cash reserve against its notes and other liabilities.

By the Presidency Bank Act of 1836 the Bank of Bengal was given the status of a Presidency Bank in 1840. Some of its Directors came to be appointed by the Government and certain curbs were put on its note-issuing powers. The Presidency Banks of Bombay and Madras were set up in 1840 and 1843 respectively. The East India Company subscribed Rs. 3 lakhs to the capital fund of both of these Banks. The note-issuing rights of Presidency Banks were subjected to certain regulations and finally came to an end during 1862–66 when Government took over the note-issuing powers from the banks. The loss involved on this account was sought to be compensated to some extent by placing Government funds with these Banks.

More than 40 banks organised in the European style came into existence between 1800 and 1858, but most of them were short-lived. All of these were predominantly owned by Europeans, but the Union Bank of India (1829–1847) had 4 Indian Directors. The Presidency Banks of Bombay and Madras also had Indian shareholders although in a very small minority.

The Bank of Bombay could not survive the financial crisis of 1866 and was re-constituted with larger capital funds in 1868. Following this setback

the Government reviewed its relations with the Presidency Banks and decided to withdraw from partnership with the Banks. After the passing of the Presidency Banks Act of 1876 the bulk of Government's cash balances was transferred from the Presidency Banks to the newly set up Government treasuries and sub-treasuries. This system of independent treasuries and sub-treasuries meant in effect that fiscal management and monetary management became unrelated to each other, a situation that created more problems than it solved. Until the establishment of the Reserve Bank of India in 1935 very little could be done to end this dichotomy.

After 1858 European banks specialising in the financing of foreign trade --the Exchange Banks as they came to be called[2]—increased in number and their business considerably expanded. The financial boom which followed the rise in cotton prices after the American Civil War also saw the emergence of a number of Indian joint-stock banks. But because of their involvement in speculative dealings most of them had to close down within a short time The first Indian-owned joint-stock bank was the Oudh Commercial Bank (1881).

In the early years of the twentieth century, a fresh wave of banking development took place as a side-effect of the 'Swadeshi' (Buy Indian) movement. It came to be realised that domestic industrial development called for the establishment of sound banks with adequate financial resources. The European banks had virtually no links with the Indian business world. Indian joint-stock banks were expected to help Indians enter those spheres of commerce and industry which had so long remained the close preserve of Europeans. Some of the bigger Indian banks of today, for example, the Central Bank of India, had their origin during the period of the Swadeshi movement (1906-11).

The newly established Indian joint-stock banks could not always manage their affairs competently. There was a lack of trained banking personnel and the importance of keeping the business of short-term lending separate from long-period mortgage banking was not always realised. In the financial crisis that overtook Indian business during the early months of the First World War many of these banks came to grief. Bank failures were also quite frequent during the difficult post-war years. As many of the smaller Indian banks had been established with a very slender capital base, they were not in a position to safeguard themselves against an adverse turn of events. The precarious character of Indian banking at the time will be evident from the fact that out of the 16 banks which failed in 1927, 6 had practically no paid-up capital, one had a paid-up capital of Rs. 800 and

2. The earliest of these banks was the Oriental Bank which started its operations in 1851. The Chartered Bank of India, Australia and China began to function in Calcutta from 1858. By 1866 there were 22 such banks, but only 7 of them survived the banking crisis in that year. See Article by Dr. Nilmani Mukherjee in *The History of Bengal (1757-1805)* edited by Dr. N.K. Sinha.

another of Rs. 1,400.[3] The necessity of exercising some regulation over the system of commercial banking in the country was becoming clearer day by day.

Meanwhile Savings Banks under Government supervision had been started in the early years of the nineteenth century. In 1817 a few District Saving Banks were set up and attached to the district treasuries. Post Office savings banks were established in the Presidency towns in 1833, but in 1863 their management was transferred to the Presidency banks. A new scheme of Post Office Savings Banks was taken in hand in 1882–83. In 1886 they took over the business of the District Savings Banks. By the end of the nineteenth century Post Office Savings Banks had been established in most districts. On the eve of the First World War there were 1.64 million deposit accounts in Post Office Savings Banks and total deposits stood at Rs. 231.68 million.[4] The outbreak of the war created a sense of panic among the depositors and deposits fell. Soon, however, confidence was restored and once again both the number of accounts and the amount of deposits began to increase.

The First World War also saw a remarkable increase in commercial bank deposits. The total deposits of all joint-stock banks in 1920 amounted to Rs. 23.53 lakhs as against only Rs. 9.75 lakhs in 1913. The high profits reaped by trade and industry during the War years as well as the rise in Government expenditure levels led to this development. Over one-third of these deposits (Rs. 8.70 lakhs) were in the three Presidency Banks, while 15 Exchange Banks and 76 Indian joint-stock banks accounted almost in equal shares (Rs. 7.48 lakhs and Rs. 7.35 lakhs respectively) for the rest of the deposits. The Presidency Banks had been prohibited, largely in the interest of the Exchange Banks, to deal in foreign exchange or borrow money abroad. Their business was largely confined to the financing of the inland trade. Since a very large part of this trade was concerned with the movement and export of agricultural products, banking business in India was also largely seasonal. The Indian joint-stock banks, with their inadequate personnel and funds, could hardly venture into foreign exchange dealings. Thus the foreign exchange transactions of the country were almost exclusively in the hands of the Exchange Banks which sought jealously to guard their privileges.

In 1921 the three Presidency Banks were amalgamated into the Imperial Bank of India. At the time this amalgamation was believed to be a step towards the establishment of a Central Bank for the general supervision and regulation of the country's commercial banking system. It was soon discovered, however, that the Imperial Bank under European management

3. Pochkhanwala, S.N., Article in Mukherjee and Dey, *Economic Problems of Modern India*, Vol. 2, p. 342.

4. Pillai, P.P., *Economic Conditions in India*, p. 277.

would not pull on well with the dominant elements in the Indian banking business. Charges of discrimination against Indian business interests were frequently brought against the Governors of the Imperial Bank. The need for a Central Bank with a purely Indian background which would impartially discharge its functions came to be stressed by business and political leaders in the country.

The Imperial Bank which came into existence in 1921 had a wider capital base than that of the three Presidency Banks which were merged in it. Its capital and reserves amounted to Rs. 15 crores as against Rs. 7 crores of the three Presidency Banks put together. The control of the Bank was vested in a Central Board of Governors including two Managing Governors appointed by the Government. The Controller of Currency was *ex officio* a member of the Central Board. There were also Local Boards in charge of the Banks' offices in Bombay, Calcutta and Madras. Indian members were nominated on all these Boards. The Government reserved to itself the right of issuing directions to the Bank in respect of matters affecting the financial interests of the Government. Like the Presidency Banks which it replaced, it was forbidden to deal in foreign exchange and raise funds abroad.

After 1921, and until the establishment of the Reserve Bank of India in 1935, the Imperial Bank functioned as banker to the Government. The system of independent treasuries, adopted in 1876, was abandoned and all treasury balances were held at the branches of the Imperial Bank. The public debt of the Government of India was managed by the Bank for a specified remuneration. The London office of the Bank was entrusted with the current accounts of the High Commissioner of India in England, formerly maintained at the Bank of England. The semi-public character of the Imperial Bank was further emphasised by the Government's directive to the Bank to open 100 branches in five years, the location of one in four branches being decided by the Government. The three Presidency Banks which were amalgamated into the Imperial Bank of India had among them 59 branch offices. By March 1926 the Imperial Bank came to have 162 branch offices of which 89 discharged Government's treasury business as well. The Imperial Bank, however, could by no means be regarded as the country's Central Bank in that it was not in charge of the note-issue nor was the management of the foreign exchange reserves entrusted to it. Its relation with the other bankers was also sporadic and unsatisfactory. Although other bankers, including indigenous bankers, would seek accommodation from the Imperial Bank in case of need, specially during the busy season, they did not find it useful to keep a certain portion of their reserves with the Imperial Bank and treat this as a part of their cash. The inevitable result was that the Imperial Bank Rate for advances, though exercising a certain amount of influence on the rates of advances of other banks and the ***bazar rate*** for ***hundis*** (indigenous bankers' inland bills), did not have that

pervasive influence on money market rates which is possessed by the Bank Rate of a Central Bank in an integrated money market. The Imperial Bank, not having the power of issuing currency notes, could not have recourse to methods which might make its Bank Rate effective.

With the establishment of the Reserve Bank of India in 1935 the Imperial Bank was shorn of those central banking functions which it had been earlier authorised to exercise. The Imperial Bank of India (Amendment) Act of 1934 brought to a close the semi-public character of the Bank and transferred the management of Government balances and the public debt to the Reserve Bank of India. At the same time the Imperial Bank was permitted to engage in foreign exchange business and borrow in foreign money markets. It was also permitted to act as the agent of the Reserve Bank of India by agreement with the latter.

The years 1929-31 witnessed a comprehensive enquiry into the structure and problems of Indian banking by a number of Provincial Banking Enquiry Committees whose findings were later reviewed by a Central Banking Enquiry Committee. In the post-World War I decade the complaint by Indian business interests that they were discriminated against by the European-dominated banking system in India could no longer be passed in silence. There were also the issues of inadequate banking development, too frequent bank failures, and the unsatisfactory relations between the different constituents of the money market. The Indian joint-stock banks were finding it difficult to expand their business because of the powerful competition of the Imperial Bank and the Exchange Banks. The Imperial Bank was not happy with the existing restrictions on the types of business in which it could engage. Its control over credit and interest rates was enfeebled by its lack of control over currency. The Central Banking Enquiry Committee was asked to examine all these issues and make suitable recommendations regarding the setting up of a full-fledged Central Bank in India.

The proposal for having a Central Bank in India was nearly a century old by the time the C.B.E.C. examined the question. In 1836 a body of British merchants had urged the establishment of a Government-owned bank to conduct the Government's banking business and provide remittance facilities to British traders in India. In 1867 a proposal was submitted by Mr. Dickson, then Secretary and Treasurer of the Bank of Bengal, to amalgamate the three Presidency Banks and set up a single bank with unified control over currency and credit. Mr. E. Hambro, a member of the Fowler Committee, proposed the setting up of a strong Central Bank to develop banking facilities in India. Mr. J.M. Keynes (later Lord Keynes) a member of the Chamberlain Commission, submitted a detailed scheme for the proposed Central Bank in collaboration with Sir Ernest Cable. Though most of the ideas underlying the scheme were accepted by the Government, it was felt at first that the Imperial Bank, formed in 1921, could serve the

functions of the proposed Central Bank and a separate institution was unnecessary. The Hilton-Young Commission finally rejected this view and pleaded for a separate, full-fledged Central Bank in the interests of sound monetary management. The Central Banking Enquiry Committee also endorsed this view.[5]

Controversy immediately arose regarding the character of this new Central Bank—whether it was to be under State ownership or should be owned by private shareholders. The Hilton-Young Commission in their report (1927) had drawn up a scheme for a Central Bank, to be designated as the Reserve Bank of India, with private share-holdings. Their argument in favour of a privately owned Central Bank was the time-honoured one that, in the interest of the country's financial stability, it was necessary to keep the Central Bank free from all kinds of political pressure. Accordingly, the Government of India introduced in January 1927 a bill to set up the Reserve Bank as a private shareholders' bank. The Legislative Assembly, however, threw out this bill and indicated its preference for a State-owned Central Bank. A second attempt by the Government in January 1928 to introduce a Central Bank with private shareholders also proved abortive. A compromise was later reached with the legislators regarding the composition of the Central Bank and a third draft of the Reserve Bank of India bill was laid before the Legislative Assembly in September 1933. This bill was enacted into the Reserve Bank of India Act in March 1934.

The Reserve Bank came into existence in 1935 as a private shareholders' bank with a paid-up capital of Rs. 5 crores divided into shares of Rs. 100 each. To prevent undue concentration of share-holding in any region of the country the shares were assigned separately to each of the five regions with their headquarters at Bombay, Calcutta, Delhi, Madras and Rangoon. There were also restrictions on the maximum number of shares allotted to an individual shareholder. Each shareholder had one vote for every 5 shares purchased, subject to a maximum of 10 votes. The Central Board of Directors of the Reserve Bank was to consist of 16 members of whom 8 were to be elected on behalf of the shareholders, 2 each by the Local Boards in Bombay, Calcutta and Delhi and 1 each by the Local Boards in Madras and Rangoon. The Governor-General in Council was to nominate 4 non-officials and 1 official as ordinary Directors. In addition, the Bank's Governor and two Deputy-Governors were to be appointed by the Governor-General in Council after considering the recommendations of the Central Board. The Local Boards in the five regions were to consist of not more

5. It was aptly said by Mr. Lovatt that "the growing political consciousness of the country.. led to the search for.. national emblems, amongst which a Central State Bank was one." It was opposition to the dominance of the Imperial Bank that gave added strength to the demand for a Central Bank. See Jathar & Beri, *Indian Economics*, Vol. 2, p 471.

than 8 members of whom 5 were to be elected by the shareholders in the respective regions and 3 were to be nominated by the Central Board. Directors and members of the Local Board were expected to represent economic interests and could not be nominated or elected from among the members of the legislature.

The Reserve Bank was divided into the Issue Department and the Banking Department, the former being responsible for the issue of paper currency and the latter for all other banking business. The currency notes already in circulation at the time were transferred to the Reserve Bank which was vested with the sole right of note-issue (except one-rupee notes). As originally provided, notes were to be issued under the proportional reserve system, not less than 2/5ths of the liability of the Issue Department being covered by gold coin, gold bullion or sterling securities, provided that the amount of gold held was not permitted to fall below Rs. 40 crores.[6] The rest of the assets of the Department was to consist of rupee securities of the Government of India, rupee coins and bills of exchange or promissory notes eligible for purchase by the Reserve Bank, but the amount of rupee securities held must not exceed one-fourth of the Department's total assets or Rs. 50 crores, whichever was greater. The issue of extra currency in case of need was permitted by the provision that the proportionality rule could be waived with the previous sanction of the Governor-General in Council and on payment of a penal tax to the Government whose amount would vary according to the length of the period for which asset requirements were held in suspension.

The Banking Department of the Reserve Bank was to hold deposits from the Government, local bodies, banks and individuals, but could not pay any interest on such deposits lest it appeared to be in competition for deposits with other financial institutions. It could transact different kinds of banking business, including buying and selling of trade bills, but the period of maturity of such bills must not exceed 90 days for commercial bills and 9 months for bills arising out of agricultural transactions. All such bills must bear the signature of a scheduled bank or a Provincial Cooperative Bank. Its loans were to be confined to the Central and local Governments, 'scheduled' banks[7] and Provincial Cooperative banks, the period of such loans not exceeding 90 days. The Bank could also buy and sell bills of exchange and promissory notes in the open market (that is, without the requirement of a signature from a scheduled bank or a Provincial Cooperative Bank) if such transactions were necessary for the regulation of credit in the country.

6. Gold being valued at that time at 8.47512 grains of fine gold per rupee.

7. A bank having a paid-up capital and reserves of Rs. 5 lakhs or more would merit inclusion in the Second Schedule of the Reserve Bank Act and was hence called a 'scheduled' bank.

The Reserve Bank was also entrusted with the responsibility of maintaining the sterling exchange standard by buying and selling sterling at specified rates. These rates were fixed at 1s.$5\frac{49}{64}$d. for sales of sterling and 1s.$6\frac{3}{16}$d. for purchases.

The Reserve Bank's relations with the scheduled banks were laid down by the Act as follows: Each scheduled bank was required to maintain with the Reserve Bank a balance equal to not less than 5 per cent of its demand liabilities and 2 per cent of its time liabilities. A scheduled bank was also required to submit a weekly return to the Reserve Bank of India. The scheduled banks were entitled to borrow from the Reserve Bank for a period not exceeding 90 days against their promissory notes supported by titles to goods. The Reserve Bank was authorised to borrow from a scheduled bank for a period not exceeding one month.

The Provincial Cooperative Banks stood in the same relation to the Reserve Bank as the scheduled banks, except that they were not required to maintain a minimum balance with the Reserve Bank, nor were they required to submit a return unless called for. Commercial banks other than the scheduled banks were initially free from any obligation to provide the Reserve Bank with information relating to their business, but by an amendment to the Indian Companies Act in 1938 it was made obligatory for all companies carrying on banking business to send weekly returns to the Reserve Bank.

The Reserve Bank was laid under a statutory obligation to present a report to the Governor-General in Council within three years from its inception containing proposals to extend the provisions of the Reserve Bank Act relating to scheduled banks to non-scheduled banks and indigenous bankers. Accordingly in 1937 the Reserve Bank indicated its willingness to enter into dealings with the indigenous bankers either (*a*) indirectly through a scheduled bank or (*b*) directly, on the condition that indigenous bankers approximate to scheduled banks, by reorganising their business with a minimum capital of Rs. 5 lakhs, maintaining a minimum balance with the Reserve Bank and segregating their non-banking business from their banking business. The minimum capital requirement was subsequently reduced to Rs. 2 lakhs. As these conditions for direct linking with the Reserve Bank were regarded as too stringent, the indigenous bankers preferred to remain aloof from the Reserve Bank, dealing with the latter, if necessary, only through the Imperial Bank or some other scheduled bank.

The Reserve Bank was intended to be specially oriented to the needs of agricultural credit. Accordingly, an Agricultural Credit Department was attached to it whose main functions were to study all questions relating to agricultural credit and to coordinate the activities of the Reserve Bank with those of other banks or cooperative organisations dealing in agricultural credit. The Agricultural Credit Department did not have any funds

of its own and, in the early years at any rate, it achieved little in developing the agricultural credit side of the Reserve Bank's business. The Reserve Bank had been laid under a statutory obligation to submit a report to the Government on the existing machinery of agricultural finance in the country within three years of its establishment. A preliminary report on this and related matters was submitted to the Government in 1936 and the Statutory Report in its final form was drawn up in 1937.

During the Second World War the Reserve Bank was under pressure to provide funds for the Government of India against Sterling securities deposited by the British Government in a blocked account at the Bank of England. It was characterised as being "for all practical purposes, a subordinate branch of the Bank of England".[8] The War had also brought about a marked concentration in the ownership of the Bank's shares, a very large fraction of such shares being now held by Bombay capitalists. It was realised during the war years that the Reserve Bank had failed to develop as a national institution with a concern for domestic stability and an interest in domestic economic expansion. Accordingly, as soon as the war ended, the demand for nationalisation of the Reserve Bank was re-iterated in the Indian legislature and the interim Government which had been installed in 1946 prior to the final transfer of power to Indian hands accepted this demand in principle. A bill to transfer the Reserve Bank to public ownership was passed by the Indian legislature in September 1948 and came into effect on 1st January, 1949.

The nationalisation of the Reserve Bank was accomplished by compensating all existing shareholders at the rate of Rs. 118-10 as. for each share of Rs. 100 held by them. The payment was made in 3 per cent promissory notes of the Central Government. After nationalisation the Central Board of the Bank was to consist of a Governor, two Deputy Governors, ten Directors (four of them representing the four Local Boards) and one Government official, all nominated by the Central Government for a term of four years. Each Local Board would consist of three Directors nominated by the Government. The Central Government took upon itself the power to give directions to the Reserve Bank in the public interest, but all such directions were to be given after consultation with the Governor.

The Central Banking Enquiry Committee had, in their report, made several recommendations for the improvement of the working of the commercial banks so that bank failures might be a thing of the past. On the basis of these recommendations the Indian Companies Act was amended in 1936 and certain special provisions relating to banking companies were inserted. The minimum share capital for a banking company was fixed at Rs. 50,000. Every banking company was required to transfer at least 20 per cent of its annual profits to a Reserve Fund until the Fund equalled its

8. Banerjee, P.N., *Indian Economics*, 6th Ed., p. 463.

paid-up capital. It was also to maintain a minimum cash balance of 5 per cent against its demand liabilities and 1½ per cent against time liabilities. No banking company could be managed by a managing agent, nor could it form, or hold shares in, a subsidiary company unless such a company was set up in furtherance of its banking interests.

The provisions thus incorporated in the Indian Companies Act did not meet the requirements of the situation. A banking crisis in 1938 underscored the importance of more comprehensive legislation for safeguarding the interests of bank depositors and securing suitable conditions of development for the banking system as a whole. Certain proposals in this regard were made by the Reserve Bank to the Government of India in November 1939. But owing to the intervention of the Second World War the proposals failed to receive due attention at the time. After the War ended, the Government of India put on the statute book the comprehensive Banking Companies Act in 1949. Its principal features were: (*a*) every banking company must hold a licence from the Reserve Bank by fulfilling certain conditions, (*b*) the minimum paid-up capital and reserves of a banking company was to be Rs. 1 lakh with additional requirements in case the banking company had several branches, while in the case of banks having a branch in Bombay city or Calcutta the additional capital and reserve requirement was to be Rs. 5 lakhs, (*c*) the minimum cash reserve against time liabilities was raised to 2 per cent, (*d*) every banking company must transfer at least 20 per cent of its annual profits to a reserve fund until the reserves equalled the paid-up capital, (*e*) it must submit periodically certain returns to the Reserve Bank, and (*f*) it must submit its books and accounts to inspection by the Reserve Bank and the latter could, on the basis of its inspection report, issue instructions to the banking company and, if required, put a stop to its banking business.

As regards Exchange Banks the Central Banking Enquiry Committee supported the view that certain restrictions ought to be put on their activities, particularly since Indian banks were subjected to various restrictions in many foreign countries. The Reserve Bank of India has since introduced a system of licensing the Exchange Banks. Under the terms of the licence the Exchange Banks are required to provide the Reserve Bank with an annual statement relating to their assets and liabilities in India.

One feature of the European-style banking system in India has been its predominantly urban character. Rural areas had hardly begun to feel the impact of modern banking even by 1950 and continued to depend for their financial needs on indigenous bankers and money-lenders. The Rural Banking Enquiry Committee set up in November 1949 addressed itself to the question of extending banking facilities to the rural areas. While stressing the importance of Post Office Savings Banks and Cooperative Societies in developing banking habits among the rural population, the Com-

mittee also gave some thought to the conditions required to induce joint-stock banks to move out to rural areas. It suggested that the Reserve Bank should arrange for more elaborate remittance facilities, while the Government should allow the rural branches of banks to use the strong-rooms of treasuries and sub-treasuries for the safe keeping of their cash. Most important in the Committee's view was the necessity of pressing into general use the receipts granted by warehouses against goods deposited with them; for this warehouses had to be constructed in all parts of the country with loans and subsidies given by the Government and the Reserve Bank to commercial banks and cooperative institutions. Such warehouse receipts could be used as a credit instrument at all levels and could be re-discounted, when necessary, with the Reserve Bank of India itself.

The Presidency Banks, we have seen, were deprived of their right of note-issue in 1862. For a few years the note-issue continued to be managed by these Banks until in 1866 the Government took over the management of the note-issue. Under the Presidency Banks Act of 1876 a Presidency Bank had to confine its working to the regions assigned to it. Restrictions were also imposed on the types of business which the Presidency Banks could transact. Thus (*a*) they could not deal in foreign exchange, (*b*) borrow or receive deposits payable outside India, (*c*) lend money for a period exceeding six months, (*d*) lend against immovable property, (*e*) lend on the security of promissory notes bearing less than two signatures or (*f*) lend against goods unless either the goods or titles to them were deposited with the lending bank as security.

Proposals to amalgamate the three Presidency Banks were made as early as 1836 and again in 1859 and 1876. Sir Everard Hambro, a member of the Fowler Committee of 1896, proposed the creation of a Central Bank in consideration of its many advantages. At the time of the Chamberlain Commission's investigations two memoranda on the proposal for a Central Bank were drawn up, one by Sir Lionel Abraham of the India office and the other by Prof. J.M. Keynes. The Keynes memorandum envisaged that the Central Bank would do business both in India and in London. The London office would be a small affair, and no competition would be offered to Exchange Banks in the remittance through bills. But this office would handle remittances on behalf of the Secretary of State for India in the most economical way. It was to hold the Government's balances in London and use them for investment in the London market. It was also to float sterling loans on behalf of the Secretary of State. The India office of the Central Bank was to hold all Government balances and manage the Note-issue. It was also to manage the Government debt in India. But the management of the mint and the keeping of the Gold Standard Reserve were not to be entrusted to it. The proposed Central Bank was to be a private bank, formed by the amalgamation of the three Presidency Banks. But although privately owned, it was to have the closest relations with the

Government. Government was to share the profits of the Bank after they had reached a certain minimum, say, 18 per cent.

The advantages of a Central Bank, as outlined in the Keynes memorandum, were: (*i*) the abolition of the independent Treasury system, which would make large balances available to the money market, (*ii*) expansion and better management of note-issue to make it more popular, (*iii*) lessening of responsibility of Government officials for note-issue, balance management, remittances and loans, (*iv*) placing of a buffer between the Secretary of State and the money market, thus eliminating vexatious criticism on small details of financial business, (*v*) scope for utilisation of officers specially trained in financial and banking work, (*vi*) moderation to some extent of wide fluctuations in the Bank Rate, specially during the 'busy' season, (*vii*) increase of branches, which the union of Government and banking business should promote, making available sound banking facilities to many parts of India which lacked such facilities (either directly or by supplying a basis on which private and cooperative banks could be built up), (*viii*) introduction of re-discount facilities, aiding the gradual development of Indian banking on the most desirable lines, and (*ix*) imparting of greater stability to the banking system and avoidance of banking crises.

The absence of a Central Bank was very keenly felt during the First World War. As a first step in the direction of having a Central Bank the three Presidency Banks were amalgamated in 1920 to form the Imperial Bank of India. The Imperial Bank was not, however, a true Central Bank, because it was not invested with the function of note-issue. The hiatus between the money-market and Government balances continued. As a partial relief the Indian Paper Currency Act of 1923 allowed a sum of up to Rs. 12 crores to be advanced to the Imperial Bank on the security of ***hundis*** The Imperial Bank was not entrusted with the function of remittance of funds to the Secretary of State, though it was permitted to open a London office. There was no provision, as in the Keynes scheme, for a sharing of profit between the State and the Imperial Bank. The arrangement between the Government and the Imperial Bank was a make-shift one, for only 10 years in the first instance.

The Imperial Bank had an authorised capital of Rs. 11.25 crores out of which Rs. 5.625 crores was paid up. The capital was divided into shares of Rs. 500 each. The Central Board was the highest authority to run the affairs of the Bank; it consisted of (*a*) the Presidents and Vice-Presidents of the three Local Boards at the three Head-offices, *viz*., Bombay, Calcutta and Madras, (*b*) Controller of currency *ex-officio*, (*c*) four non-officials nominated by the Governor-General in Council, (*d*) the Secretaries of the Local Boards, and (*e*) two Managing Governors appointed by the Governor-General in Council. The Central Board set up a small Managing Committee. The Local Boards managed the Head offices in their respective localities.

A general meeting of the Bank's shareholders had to be held each year on the first Monday of August. At this meeting the Central Board submitted an Annual Statement (July-June) of affairs.

The establishment of the Imperial Bank did not remove the difficulty of dual control of currency and credit, the currency being managed by the Government and credit by the Imperial Bank. As the Hilton Young Commission observed, "The Government controls the currency. The credit situation is controlled, so far as it is controlled at all, by the Imperial Bank. With divided control there is likelihood of divided counsels and failure to coordinate. The only certain way to secure coordination is to concentrate the controls in one hand. In other countries the single controlling hand is that of a Central Bank."[9] It was, however, not desirable to convert the Imperial Bank into a Central Bank, as then the Imperial Bank would have to be bound by various restrictions and would be prevented from its other important task of extending banking facilities in India.

The Hilton Young Commission therefore proposed that a new institution called the Reserve Bank of India should be set up to discharge central banking functions. It should be a private shareholders' bank with a share capital of Rs. 5 crores. Its affairs should be managed by a Central Board and Local Boards in a manner analogous to that of the Imperial Bank. The Commission recommended a Central Board of 14 members, *viz.*, President, Vice-Presidents and one elected member from each of the three Local Boards, the Managing Governor and Deputy Managing Governor appointed by the Governor-General in Council for five years and three non-officials also nominated by the Governor-General in Council. To eliminate political pressure it was to be stipulated that no person shall be appointed to the Central Board, if he is a member of the Governor-General's or Governor's Councils, the Council of State, the Legislative Assembly or the Legislative Councils. The Government should have a share in the Bank's profits.

The Commission envisaged the Bank's essential functions as follows: all remittance operations of the Government in India and London[10] (thus relieving Government of operations in the exchange market) and management of the note-issue (with the notes guaranteed by the Government). To meet the seasonal demand for credit and currency the Commission proposed that the Reserve Bank should be empowered to issue notes against the security of commercial bills.[11]

Before the establishment of the Reserve Bank of India in 1935, the 'Bank Rate' in India was the rate at which the Imperial Bank of India would ordinarily advance money against Government Securities. The Imperial

9. Hilton Young Commission Report, para. 20.

10. Annual remittance at this time amounted to some 35 million pounds sterling, a large sum in relation to total outward remittances from the country.

11. Sir P. Thakurdas was opposed to this, because in his view this would mean competition for inland bills between the Imperial Bank and the Central Bank.

Bank *Hundi rate* was the rate at which the Imperial Bank would discount or re-discount first class three months' bills. This would normally be equal to or ½ per cent above the bank rate. The *bazar rate* was the rate at which the bills of smal traders used to be discounted by shroffs (usually about 3-4½% above *Hundi rate*). Rates for bills of large traders and shroffs followed closely the Imperial Bank *Hundi rate*.

During the slack season (July-October) the Imperial Bank's cash balances would reach their maximum and both the bank rate and the bank *Hundi rate* would be relatively low. The balances would be depleted when the busy season commenced in order to meet the financial needs of traders moving important commercial crops from the interior to the towns and ports. At this time money rates would normally move up.

Important developments had taken place years after the First World War in the system of Government remittances to London. The main method by which the Secretary of State was placed in funds before the war was through sale by open tender of council bills; the same method was maintained during the war with some modifications, *viz.*, (*a*) since December 1916 the 'intermediate' drafts which were regularly sold between the weekly auctions were suspended, and (*b*) there was no provision for sale of rupees without limit. No sales of council bills took place in London between the date of publication of the Babington Smith Committee Report and January 1923. After that date the sales were supplemented by purchase of sterling by the Government of India in India. The sterling so purchased was credited to the Secretary of State in the Bank of England. From January 1923 to December 1925 nearly £94 million were so transmitted as against £23 million realised by the sale of council bills in London. For the sterling purchased the rate selected was generally 1s.6$\frac{3}{16}$d. which corresponded to the upper gold point on the basis of a 1s.6d. rupee. In 1925–26 the method of remittance by purchase of sterling in India was exclusively adopted, no council drafts being sold.

The Babington Smith Committee recommended that the statutory minimum for the metallic portion of the Paper Currency Reserve should be 40 per cent of the gross circulation. This was a radical departure from the fixed fiduciary principle. The Committee also recommended that with a view to meeting seasonal demand for additional currency, provision should be made for the issue of notes up to Rs. 5 crores as loans to the Presidency banks on the security of export bills. The metallic portion in the reserve was to be held in India. On the basis of these recommendations the Paper Currency Act was consolidated in 1923. The metallic reserve was, however, fixed at 50 per cent instead of 40 per cent.

At the close of the First World War the Gold Standard Reserve stood at £40 million. The entire amount was invested in sterling securities and British treasury bills. The interest on these securities was credited to the revenues of the Government of India after 1923. The Hilton Young Com-

mission recommended the unification of the Gold Standard Reserve and the Paper Currency Reserve. The first responsibility of this amalgamated reserve was to ensure the convertibility of notes into gold. At least 40 per cent of the notes in circulation were to be backed by gold or gold securities.[12] Since the same reserve was also to ensure external exchange stability it was suggested by the Hilton Young Commission that besides the 40 per cent rule for ensuring domestic convertibility, some amount (say, Rs. 50 crores) should be held in reserve against this commitment. If silver rupees were presented for conversion into gold this portion of the reserve was to be utilised.

With the establishment of the Reserve Bank of India in 1935 the administration of the country's monetary reserves was transferred from the Central Government to the Reserve Bank, as already seen.

The Reserve Bank initially followed a policy of consolidation rather than of systematic expansion and was often blamed for not coming readily to the rescue of the Indian banking companies in trouble. Yet the very existence of the Reserve Bank certainly exercised a healthy influence on the banking system as a whole, instilling greater confidence into both bankers and bank depositors.

By 1950 India had over 4,300 banking offices, but this was still too small in relation to the size and population of the country. However, the decline over the years in the number of non-scheduled banks through consolidation as well as liquidation of uneconomic units was a healthy development. The hold of the Reserve Bank of India over the commercial banking institutions was considerably strengthened after 1949 and the way to the emergence of a more unified money market was being explored.

Nationalisation of Major Commercial Banks after 1955

The first step in the nationalisation of commercial banks was taken in 1955 when the biggest commercial bank in the country, the Imperial Bank of India, was nationalised and re-christened as the State Bank of India. This act of nationalisation was resorted to primarily in order to make commercial bank credit available to rural areas. The State Bank's statute required it to open at least 400 branches within five years. This target was exceeded.

In the 1960s it became quite evident that, without a much more liberalised supply of credit for agricultural pursuits, the benefits of new technologies of agricultural production could not be reaped. Till then the bulk of commercial bank credit was for use in industry and commerce. Farmers, small artisans and petty traders had to borrow at exorbitant

12. At least half of this reserve was to be held in India and the minimum amount of gold in the reserve was to be Rs. 30 crores.

interest rates from non-institutional sources which included large traders. The blending of trading and money-lending activities led to excessive spoliation of the weaker segments of society. Therefore, when 14 major commercial banks of the country came to be suddenly nationalised on July 19, 1969, this action was held up as part and parcel of a programme of poverty eradication (garibi hatao) launched by the Indian National Congress (Indira group) after a split between two factions of the Congress Party.

After July 1969 the public sector banks have been encouraged and induced to open hundreds of branches, paying special attention to formerly unbanked areas. The banks' branch expansion schemes are subject to the regulations framed by the Reserve Bank of India. By 1983 the number of bank offices in the country had increased more than five-fold, from 8,187 offices in June 1969 to 43,209 in June, 1983. Bank offices in rural areas increased during the same period from 1,443 to 21,981. But although nearly 51 per cent of bank offices were operating in rural areas, the share of rural branches in total bank deposits was only 14 per cent and their share in aggregate credit disbursed was 12.4 per cent. At the other end of the spectrum, bank offices in metropolitan centres accounted for 11 per cent of the total number of branches, but received 37.5 per cent of total bank deposits and disbursed 48.2 per cent of aggregate bank credit. Between these two extremes lay the semi-urban and urban branches, accounting for 38 per cent of bank offices and 48.4 per cent of deposits, but only 39.4 per cent of bank credit. Thus the bias in the banking system towards commercial and industrial activities, centred on metropolitan areas, continued almost unabated. An outflow of bank funds from less developed rural and semi-urban areas to the more developed urban and metropolitan areas indicated a degree of unevenness in development.

Within the limits imposed by exogenous factors the rural branches were able to utilise a larger portion of their loanable funds for agricultural purposes. Between June 1973 and June 1983 the share of agriculture in the credit sanctioned by rural bank offices rose from 26.8 per cent to 50.7 per cent. Besides agriculture, some other categories of borrowers, such as small industry, retail trade and transport business, also received special attention from the commercial banks after nationalisation. The number of borrowing accounts in these 'priority sectors', which was as low as 2.60 lakhs in June 1969, rose to 135.74 lakhs by June 1981. The share of these sectors in total credit rose from 14.6 per cent to 36.4 per cent during the same period.[13] The average size of loan sanctioned, however, declined from about Rs. 17,000 to Rs. 6,500, although prices were on the rise. The preponderance of small loans was likely to reduce the effectiveness of the loans granted and might create difficulties in respect of loan recovery.

13. The target was to raise this share to 40 per cent by March, 1985. This target was achieved before the due date.

On April 15, 1980, another 6 commercial banks came to be nationalised. But branch expansion by nationalised banks was soon found out to be too costly a method for providing rural credit. It was thought desirable to have a separate set of institutions, which could be operated with less expense and provide credit to rural borrowers with a minimum of formalities. Such institutions came to be called Regional Rural Banks. The growth of branches of Regional Rural Bank has further extended the network of rural bank offices in India.

19

Government Finance Before and After Independence

We know from Lord Clive's letter to the Court of Directors of the East India Company dated 30th September, 1765 that on the acquisition of the Diwani of Bengal, Bihar and Orissa the Company's Indian revenues were anticipated to be in the neighbourhood of Rs. 2.50 crores per year. This was expected to go up by Rs. 20 or 30 lakhs in subsequent years. The Company's expenditures for other than trade purposes were as follows:

	Rs. Lakhs
Upkeep of civil and military establishment	60
Allowances to the Nawab of Bengal	42
Tributes to the Emperor at Delhi	26
	1,28

The balance furnished the means of financing the Company's 'investment'. By the term 'investment' was meant 'the amount set apart in the purchase of goods for exportation to England.'[1] The size of this investment was for many years taken as the yardstick of success of the Company's ventures in India. From the Indian point of view, however, the financing of the Company's commercial purchases by this particular method meant a slowing down of the influx of precious metals into the country with its stifling consequences on the expansion of trade and capital creation. Although the quantum of investment by the Company was a principal means of sustaining the demand for many kinds of goods, notably textiles, after domestic demand had started falling off, it must be recognised that the exports financed in this way were without any *quid pro quo*. Whatever their role in keeping up industrial employment in the country for some years before such employment was finally squeezed out by the new industrial technology of the West, a succession of years of 'unrequited' exports undoubtedly weakened the productive base of the economy. Moreover, trading profits were heavily concentrated in the hands of Europeans who preferred to remit such profits to Europe, thereby adding to the magnitude of the goods 'drain'. (See *supra*, Ch. 3.)

1. Dutt, R.C., *Economic History of India, 1757–1837*, p. 34.

In 1813 the territorial revenues of the Company were directed to be separated from the commercial revenues. The object was to earmark territorial revenues for the upkeep of the Company's Civil and Military Establishments and for the payment of interest on the Company's Indian debt. The commercial profit of the Company was to be applied to the payment of bills of exchange and the payment of interest on other debts, the repayment of debt, and the payment of dividends to the Company's shareholders.

The average annual territorial revenue from the Company's territories during the period 1813–1828 amounted to over £20 million. The bulk of this revenue was derived from the then Presidency of Bengal which contributed nearly £13.1 million per year. The Presidency of Madras yielded £5.5 million a year, Bombay £2.8 million, and Oudh and other settlements less than £1 million. The average annual 'Home charges' met out of this revenue was £1.7 million. The expenditure usually exceeded the revenue, the average annual deficit during the period mentioned above being £1.2 million.

As can be expected, land revenue formed the bulk of the Company's gross revenue collections. During 1813-28 the average annual collection from land revenue was nearly £12.5 million, which came to about 62.5 per cent of the aggregate revenue. The other sources of revenue were: duties on internal trade and transit, duties on exports and imports, net revenue from the sale of opium and salt, etc.

Duties on internal trade were a legacy from the pre-British period. They were recognised to be a source of vexatious interference with trade and a breeding ground for corruption. But financial requirements were so great that even such an obnoxious source of revenue could not be given up until about the middle of the nineteenth century. The annual revenue from this source was of the order of £220,000. The usual rate of imposition, as prevalent after 1801, was 3½ per cent *ad valorem*.

Customs duties were generally charged at 7½ per cent *ad valorem*, with a 5 per cent rate on a number of chosen articles and a 10 per cent rate on a few luxury goods. In 1811 duties leviable on goods carried in foreign vessels were raised to double these rates, while goods carried in British ships continued to pay the lower rates. Non-British vessels were debarred at the same time from engaging in coastal trade. Further favour was shown to certain imports from England in 1815 when a 2½ per cent duty came to be levied on some categories of imports, while a few other items were altogether exempted from the payment of import duties. In the case of certain export items also, such as cotton, indigo, wool, hemp and *sunn*, similar favourable treatment was accorded to goods despatched for Britain in a British or Indian-built ship. But until 1823 no relief in export duty was granted to Indian cotton piecegoods although exports of such piecegoods

were becoming increasingly difficult in the altered environment of Indo-European trade.

The preference system was given a further dimension in 1825. While British goods continued to pay either no duty at all or a 2½ per cent duty, goods from the rest of Europe and from the United States were generally required to pay 5 per cent and goods originating in any other country were subjected to a duty of 7½-10 per cent. The rates would be double in each case if the goods were carried in foreign ships. Corresponding preferences were introduced on the exports side for British and European countries and for the United States.

The above rates related to the port in Calcutta. Ports in Bombay had, in general, a lower scale of duties. Madras also had relatively low duties until 1803 when customs tariffs were sharply increased.

The abolition of duties on internal trade after 1836 necessitated a greater recourse to sea customs. Accordingly the customs regulations were thoroughly revised in the 1840s, one consequence of which was to do away with the discrimination between British and foreign vessels. But the discrimination in favour of goods of British origin continued for several years more.

The costs of suppressing the Indian Mutiny in 1857 added substantially to the Government of India's financial liabilities. The post-Mutiny policy of maintaining a larger contingent of British troops in India also added to the defence expenditure. Among other measures adopted to augment government revenues, an enhancement of the import duties was proposed. Discrimination of every sort was abolished and a uniform import duty of 20 per cent *ad valorem* was adopted for most luxury goods. Specific duties were imposed on wines, spirits and beer, but the rates amounted approximately to 20 per cent of value. A few articles of common use, notably cotton piecegoods, were to be charged 10 per cent. The duty on cotton thread, twist and yarn was fixed at 5 per cent. Books, raw cotton, bullion and machinery of most kinds were on the free list. The export duties were generally left unchanged except for the duty on grain which was raised from ½ anna per maund to 2 annas per maund. Two important articles on the list of goods exempt from export duties were silk and tobacco. It was the declared intention of the government that tariffs should have no protective effect whatsoever, but should be levied solely for revenue purposes. The Tariff Act of 1859 established a uniform tariff for the whole of India, superseding the earlier system of separate tariffs for the three Presidencies.

The enhancement of the import duty on cotton piecegoods in 1859 gave rise to some opposition from the European mercantile interests operating from Bombay. These interests pointed out that a cotton textile industry had already come into existence in the country and it would be unwise to put restrictions on imports of cotton piecegoods if competitive conditions were to be maintained in this segment of the country's economy.

The tariff measures of 1859 had probably gone too far, for imports started falling in the wake of the high rates adopted. Accordingly in 1860 the rates were brought down to 10 per cent, though the duties on cotton twist and yarn were in fact *raised* to 10 per cent from the prevailing rate of 5 per cent. A fairly large number of additions were made at the same time to the free list of imports. With regard to export duties the Finance Member enunciated his general policy of reducing such duties wherever possible, since such duties imposed impediments in the way of Indian goods in foreign markets. But he raised the export duty on saltpetre in consideration of the monopoly which this article enjoyed in foreign markets, particularly since the revenue loss due to the reductions made in import duties had to be somehow made up.

In the very next year, however, the duty on cotton twist and yarn was brought down once again to 5 per cent. Mr. Samuel Laing, the new Finance Member of the Government of India, declared that an article like cotton twist or yarn should not be charged so high a rate of import duty as to encourage the growth of a rival industry in India under a protective shelter He even expressed his conviction that the duty on cotton piecegoods should also be reduced to 5 per cent, but the state of the government's finances at this time did not permit him to carry his conviction into action. The loss in revenue caused by the reduction in the duty on cotton twist and yarn was made good by enhancing the duty on salt.

In the budget for 1862–63, however, Mr. Laing succeeded in effecting a reduction in the duty on cotton piecegoods. From 10 per cent *ad valorem* the rate of duty was reduced to 5 per cent, while the duty on yarn was further reduced to 3½ per cent. An ardent free trader, Mr. Laing refused to "bestow on Indian manufacturers the fatal boon of a temporary and precarious protection." But it would be unfair to suggest that his policy was to discourage the growth of Indian manufactures. In his Financial Statement Mr. Laing disowned any such intention in the clearest possible terms. "I see no reason," he said, "why the interchange between India and Europe should be confined to agricultural products against manufactures and why, in course of time, manufactures of certain descriptions where India has a natural advantage may not enter largely into her staple exports."[2] His free trading conscience, however, would not allow him to speed up any such natural process by protecting the 'infant industries' even for a short period?

In 1864–65 there was a further general reduction in import duties under the then Finance Member, Sir Charles Trevelyan. The rate of duty on most goods, formerly at 10 per cent *ad valorem*, was now reduced to 7½ per cent. This was made possible by the improvement in other revenues which left government with a surplus in their revenue budget. In the

2. Banerjee, P.N., *History of Indian Taxation*, p. 179 f.n.

following year, when financial conditions deteriorated, the Finance Member took the line of least resistance by putting up export duties on articles like jute, hides and tea for which the foreign demand had been increasing during the 1860s. Unlike his predecessor Sir Charles obviously believed that export duties are ultimately borne by the foreigner. Nevertheless trading interests frequently raised their voice against export duties, specially on rice and sugar.

The import duties on yarn and cotton piecegoods at 3½ and 5 per cent respectively were so long regarded as having no protective implications. But in 1874 the Manchester Chamber of Commerce suddenly came out with a protesting memorial, addressed to the Secretary of State for India, alleging that these duties were laying the foundations of an inefficient cotton yarn and textiles industry in India. In the memorial concern was also expressed for the rise in the price of such an essential consumer good as cloth as a result of the import duties. In a subsequent letter the Chamber expressed its concern also for government revenues. Since a large number of new cotton mills were being projected at the time, imports were bound to dwindle and the purpose of the so-called revenue duties would be defeated.

The matter was referred by the Government of India to a Committee which was set up about this time to make a comprehensive review of the Indian tariff. The Committee rejected the plea of the Manchester merchants on the ground that, in spite of the growth of domestic production of cotton textiles, imports were still very considerable and the revenue from the import duties on yarn and piecegoods could hardly be sacrificed. However, to placate the Manchester interests the Government of India proposed to introduce, in 1875, a 5 per cent import duty on long-staple cotton. Export duties were mostly abolished by the Tariff Act of 1875, except for three commodities, *viz*., rice, lac and indigo.

The Government of India's unwillingness to oblige Manchester by abolishing the cotton duties, or alternatively by imposing an excise duty on Indian cotton textiles production, angered the Secretary of State for India, Lord Salisbury, who was a staunch supporter of the Manchester industrialists' point of view. He asserted his right of dictating the Indian tariff to the Indian Government. But the Governor-General, Lord Northbrook, was not prepared to concede such a right. He resigned his post in protest and was succeeded by Lord Lytton who had earlier declared himself to be a supporter of the abolition of the cotton duties.

A Resolution passed in the British House of Commons in August 1877 unequivocally declared that the existing import duties on cotton manufactures were protective in nature and called for their abolition as soon as financial conditions in India permitted such abolition. The Resolution was clearly contradictory, since the abolition of a truly protective duty could hardly affect the financial conditions adversely. The first actual step towards the abolition of cotton duties was taken in 1878 when the duties on certain

coarse varieties of cloth were taken off. It was believed that competition between the Indian and British cotton industries was closest in these varieties and the abrogation of duties on these varieties would abolish the element of protection in the cotton duties. The loss of revenue, even from this limited step towards free trade in cotton textiles, was not inconsiderable and fresh tax sources had to be tapped to make up for the loss.

Next year the Governor-General used his emergency powers to abolish the import duties on cotton piecegoods of comparatively finer varieties after overriding the objections of the majority in his Executive Council. The proposals were not placed before the Legislative Council at all. This being a period of extreme financial difficulties for the government, owing to expenditure on famine relief and the fall in the rupee exchange, Lord Lytton had little justification for taking such a step involving considerable sacrifice of revenue without taking his Executive Councillors along with him. The pressure from Manchester and the Secretary of State was, however, so great that the Governor-General had to act according to their wishes irrespective of financial and economic considerations.

The political consequences of such open and unabashed alliance of the Government of India with the British cotton mill owners were, however, not negligible. Indian public opinion turned against the government when it became crystal clear that government's fiscal policy was intended to serve British, rather than Indian, interests. In fact, the measures under consideration caused a loss of nearly £200,000 per year to government revenues at a time when the financial situation was by no means easy. It should be noted that on this ground the measures were opposed even by some members of the India Council which was an advisory body to the Secretary of State.

The goal of completely free trade was now within sight. In 1880 all export duties were abolished with the exception of the duty on rice. As the finances of the government had improved in the early 1880s, full abolition of all import duties, with the exception of the duties on arms and ammunition, wines and liquors, opium and salt, was decided upon in the budget for 1882–83. The Finance Member, Sir Evelyn Baring, declared that by accepting the principle of free trade India was simply following the path charted by England and expressed the hope that just as free trade had proved beneficial for England, so it would be for India. The idea of *stages* in economic growth had not yet seen the light of the day.

In advocating a policy of total abolition of all import duties the authorities had held out the prospect that the removal of such duties would lead to a general increase in demand for commodities and enhanced prosperity for all. Nothing like this actually happened. It was then suggested that the falling exchange value of the rupee might be responsible for the continued depression in trade and industry, while the thrifty nature of the people might also be a factor in accounting for the low price elasticity of demand

in the Indian market. Whatever may be the truth, it remains obvious that the free trade experiment in India, short-lived that it was, left no lasting effect on economic performance or on the general attitude of the people towards such issues as the significance of unfettered competition.

The reversal of the free trade policy was forced by the decline in the government's budgetary surplus after 1884. At first other expedients were tried. But as the situation did not improve, a 5 per cent duty on imported petroleum was proposed in 1888. Following discussions in the Legislative Council this was changed to a specific duty. In 1890 the duty on intoxicating liquors was raised. These minor imposts did not yield much additional revenue. As the financial difficulties mounted after 1893, few alternatives were left except to re-introduce a comprehensive system of import duties. The Secretary of State accepted the Government of India's proposals in this respect, but he declined to give his assent to the inclusion of cotton yarn and piecegoods in the list of articles subject to tariff. These, he insisted, must remain on the free list. The exclusion of cotton goods from the new tariff, levied generally at 5 per cent *ad valorem*, meant that revenue from customs was lower than it could otherwise be. But the financial difficulties of the period called for more extensive measures. At last, in May 1894, the Secretary of State for India agreed to permit the Government of India to re-introduce import duties on cotton goods, but only on the condition that either goods directly competitive with Indian cotton manufactures be exempted from such duties or excise duties equivalent to the import duties be imposed on those classes of goods to equalise the conditions of competition. With such *countervailing* excise duties, an import duty at 5 per cent was re-imposed on cotton yarn in December 1894. A 5 per cent excise duty on cotton yarn above 20s count was imposed at the same time, but no excise duty on piecegoods was levied. The Manchester manufacturers took exception to this. On their suggestion the import and excise duties on yarn were abolished in 1896 and a 3 per cent import duty on manufactured cotton cloth, along with a countervailing excise duty at the same rate, was imposed. These rates applied to cloth of all counts, whether or not they were directly competitive with British goods. These changes in import duties caused a loss in revenue of nearly Rs. 5 lakhs.

There can be little doubt that Indian tariff policy up to the end of the nineteenth century was guided more by considerations of British than of Indian interest. The opening years of the twentieth century saw some changes in this respect. In 1899 a tariff was specially devised against the flooding of the Indian market by the bounty-fed beet sugar from Western and Central Europe. Even in this case, however, the principal consideration was not so much the prevention of injury to Indian sugar producers as the creation of easier conditions for increased imports into India of sugar from the British colony of Mauritius. The scope of this 'safeguarding' action was extended further during 1902–03.

Revenue considerations led to some upward revision of tariffs in 1910, tobacco being one of the commodities taxed at a higher rate. This led to agitation by British manufacturers of tobacco with the result that the Government of India was forced in the very next year to reduce the tobacco duties. The next upward revision in tariffs came in 1916 when the demands of the First World War made the raising of additional revenues unavoidable. The general rate of import duty was raised from 5 to 7 per cent and certain articles formerly allowed free were subjected to duties varying from 2 to 7 per cent. There was a revival of export duties as well, notably on jute and tea. It may be noted that even during this period of acute financial difficulties the import duty on cotton piecegoods was left unchanged at 3 per cent.

The year 1917 saw further enhancement in customs duties. The export duty on jute goods was doubled. The import duty on cotton piecegoods was now permitted to be raised to 7 per cent after repeated representations by the Government of India to the Home government. The countervailing excise duty on cotton piecegoods was left unchanged at 3 per cent. This was the first indication of a reversal in the balance of forces under which Indian tariff policy was being guided by the dictates of Whitehall. Talks for a further dose of Constitutional reforms in India were due at this time. Very naturally the British Government did not want to exacerbate Indian public opinion at such a moment. In fact, the Report of the Joint Parliamentary Committee on Indian Constitutional Reforms recommended that, while the Secretary of State had in theory every right to intervene in all aspects of Indian affairs, he should, as a special gesture, refrain from interfering in fiscal matters so long as the executive and legislative branches of the Government of India were united in their demand for a certain type of fiscal policy.

The immediate post-war period was marked by difficulties in balancing the budget. In 1920 a 15 per cent export duty was imposed on hides and skins, the rate being 10 per cent in the case of exports to any part of the British Empire. This measure of Imperial Preference was vigorously opposed by Indian members in the Legislative Assembly, but the Government could not be made to yield on the question of such preference.

The general import duty was substantially revised upwards in 1921. In place of the 7 per cent *ad valorem* rate so long prevailing, the common rate became 11 per cent. Cotton manufactures were included in the general list, but the countervailing excise duty on cotton goods remained at 3 per cent. The duties on certain luxury items were raised to 20 per cent. Although the higher duties on imports of cotton goods were resented by British exporters of such goods to India and a deputation on their behalf waited upon the Secretary of State, Mr. Montagu, the duties were allowed to remain as proposed, the Secretary of State pleading his inability to interfere with the policy of the Government of India.

The general import duty was further raised to 15 per cent in 1922.

Cotton manufactures were proposed to be included in the general list. But this time the cotton excise duty was also brought up for revision and the Finance Member proposed to raise the rate of this duty from the existing 3 to 7½ per cent. This was not acceptable to the Indian legislature. A compromise was then accepted. The excise duty remained at 3 per cent, while the import duty on cotton goods came to be levied at 11 per cent.

In 1923 the export duty on hides and skins was reduced from 15 to 5 per cent and the preference established in favour of countries in the British Empire was given up. The issue of Imperial Preference, along with the question of using tariffs for protective purposes, was being examined at this time by the Fiscal Commission under Sri Ibrahim Rahimtoola. The Government of India agreed to keep in abeyance all measures of a preferential nature until the Commission's Report was available.

In 1925 the *ad valorem* duty on sugar imports was converted to a specific duty. This was in effect a protective measure intended to insulate the Indian sugar industry against falling prices of sugar abroad. As world prices had started falling, the high *ad valorem* duties which in the immediate post-war years afforded some measure of protection to indigenous producers had lost their effectiveness and stood in need of revision. The Taxation Enquiry Committee of 1924–25 made a careful study of all taxes, including customs duties, then being levied in the country and suggested some measures of change.

An immediate consequence of the T.E.C.'s recommendations was the abolition of the cotton excise duty in December 1925. Already in 1916 Lord Hardinge, the Governor-General of India, had given the assurance that this duty would be abolished as soon as the financial position of the government permitted. This pledge was redeemed when the Finance Minister anticipated a revenue surplus of Rs. 3 crores in the 1926–27 budget. The loss from the abolition of the cotton excise duty was estimated at Rs. 1¾ crores.

Budgetary surpluses permitted further reduction of customs duties during 1927-29. Hides and skins and tea benefited from the abolition of export duties, while imports of motor cars and tyres were permitted entry at lower import duties. Import duties on tobacco and motor spirits were, however, raised to about 50 per cent.

The years of the Great Depression were hard for the financial authorities. As trade shrank in value, the yield from the customs duties fell sharply. The nationalist movement with its emphasis on the boycott of British goods was also responsible in some measure for the deterioration in government finances. The yield from customs fell from Rs. 51.28 crores in 1929–30 to Rs. 46.44 crores in 1931–32. To meet the situation the government introduced, among other measures, special surcharges on the customs duties, the rate of the surcharge varying from 2 to 15 per cent of the basic duty. On the conclusion of the Ottawa Trade Agreement in 1932 the tariff

rates were overhauled to give effect to the policy of preferential treatment for goods imported from the rest of the British Empire. The general *ad valorem* rate, after this overhaul, reached 50 per cent in some cases. In 1939 import duties on British cotton piecegoods were reduced in accordance with the terms of the Indo-British Trade Agreement of that year.

The outbreak of the Second World War adversely affected the customs revenues once again as the established foreign trading system of the country was disrupted. The customs revenue which stood at Rs. 40.51 crores in 1938-39 fell to Rs. 25.12 crores in 1942-43. With the revival of trade in the period after the war, as well as due to the all-round increase in prices, revenue from this source recovered towards the end of the war period. In 1949-50 customs yielded over Rs. 111 crores.

It was stated above that a duty on salt was a feature of the East India Company's revenue system. The duty was not introduced by them, but was taken over from the Mughals. "Towards the end of the Mohammedan administration an *ad valorem* duty of 5 per cent was levied on Hindus and 2½ per cent on Mohammedans upon all salt passing the town of Hughly on its way into the interior of the country."[3] The duty on salt was thus included in the general system of transit duties during the Mughal period.

The East India Company converted this transit duty into an excise (a tax on manufacture) in 1762. Three years later the senior officials of the Company established their monopoly over the inland trade in salt, betel-nut and tobacco by establishing a Society of Trade whose membership was to remain confined among themselves. This monopolistic arrangement had to be abandoned in 1768 at the behest of the East India Company's Directors and free trade in salt was restored along with an excise duty at the stage of manufacture. The duty was fixed at 30 *sicca* Rs. per 100 maunds.

The revenue from the salt excise, however, proved unsatisfactory. In 1772 Warren Hastings decided to establish the Company's exclusive right over salt manufacture by introducing a system of five-yearly leases for the right of salt manufacture. But the system of lease also did not work well. The Company decided in 1780 to bring the manufacture of salt under the direct supervision of its own officials. The difference between the cost of manufacture and the price at which salt was sold amounted roughly to Rs. 1-8 as. per maund. The salt revenues improved considerably after the system was adopted. When Lord Cornwallis introduced a system of sale by public auction, instead of sale at a fixed price to wholesalers in 1788, revenues increased even more. The average annual revenue derived from the sale of salt in the three years preceding the Report of the Parliamentary Committee of 1832-33 amounted to over £1.6 million. A substantial part

3. Ninth Report of the Select Committee, 1783, as quoted in Banerjee, P.N., *History of Indian Taxation*, p. 249 f.n.

of the profit must be attributed to the exploitation by the Company's agents of the native workers (malangis) in the salt manufactories. The average price which salt fetched at the monthly auctions was nearly three times its cost of manufacture.

The salt monopoly had come in for a good deal of criticism for its harsh treatment of the salt workers as well as for keeping the price of a necessity of life artificially high. A Parliamentary Select Committee in England studied different aspects of the salt monopoly during 1835–36. They concluded in their Report that the monopoly had produced many evil consequences and should be replaced by a system of private manufacture and trade from which the government should obtain revenues through appropriate customs and excise duties. But if an immediate abandonment of the monopoly was not possible for financial reasons, at least the old system of sale at fixed prices ought to be re-introduced, they felt, in place of the system of periodical auctions. This was done in 1836. Import of foreign salt was also permitted after 1817. The scale of duty on salt and the sale price were reduced in 1844, and again in 1847 and 1849. With the fall in salt prices, consumption went up markedly, so that the salt revenue did not decline as much as was apprehended.

The Plowden Report of 1853 once again came out in favour of an excise duty on salt replacing the existing system of state monopoly of salt manufacture. The Government of Bengal made a hesitant experiment with the new system in 1854, but only on a very small scale. Nobody was yet prepared to tamper with a system which yielded a net annual revenue of over Rs. 1.4 crores in Bengal (1854–55) and over Rs. 45 lakhs in Madras. The system in Bombay, however, was different. There the salt duty was a part of transit duties up to 1836; in 1837 an excise duty began to be charged on all salt whether produced in government-owned works or private works. In 1857–58 the net revenue derived in all Provinces from salt (monopoly profit plus excise duties) was £2.1 million exclusive of customs duties on imported salt. The latter amounted to £1.1 million in 1857–58. Salt revenues represented nearly 10 per cent of the Company's revenues on the eve of the transfer of power to the British Crown.

In 1859-60 the rates of duty on salt were raised to yield an additional revenue of £1 million. There was further increase in 1861. By this time imports of salt had so increased that domestic manufacture of salt became uneconomical in Bengal and the government decided to withdraw from salt production. In Madras and the North Western provinces salt manufacture continued. Though there were some attempts in the 1860s to introduce uniformity among the different Provinces in the taxation of salt, varying rates of duty continued to be levied. By the 1880s, however, the duty on salt in most parts of India, except Burma and western Punjab, had been standardised at Rs. 2 per maund. The net salt revenue amounted in 1881–82 to £6.8 million.

Financial difficulties led to a general increase in salt duties in 1888. But as prosperity returned at the beginning of the century, the government began to think of reducing the salt duty. Though the government never agreed that the salt tax pressed heavily on the people, public opinion in India was beginning to grow restive on the issue of abolishing this duty which amounted virtually to a poll-tax. The rate of salt excise was reduced by stages between 1903 and 1907 to Re. 1 a maund.

The exigencies of the First World War reversed this trend towards reduction. In 1916 the duty was raised to Rs. 1-4 as. a maund. But the government's proposal to increase the duty further to Rs. 2-8 as. a maund in the early 1920s raised a storm of protest in the Legislative Assembly. The bill containing the tax proposal was twice thrown out by the Legislature and was passed in 1923 on the strength of the special powers conferred on the Governor-General by the Government of India Act, 1919. In the next budget, however, the government bowed down to the opposition and the duty on salt was brought down to Rs. 1-9 as. per maund in September 1931. Nationalist opinion in India was in favour of complete abolition of the duty on salt. With this end in view a resolution was moved by the opposition in the Indian legislature in 1936. But the government was then passing through a financial crisis and was hardly in a position to accept such a proposal.

The salt tax was undoubtedly a regressive tax. But being an old tax it had perhaps ceased to be felt. At the rate of Rs. 1-4 as. per maund the tax burden was probably not so high as to be a contributory cause of economic distress, although to the very indigent even this small burden might be hard to bear. The nationalist agitation against the salt tax was more symbolic than sound; the common nationalist theme that an item of daily necessity like salt should be as free as air or water did not carry much conviction when shortage of food frequently plunged the country into grave distress. There was, however, greater justification in criticising the system under which salt was manufactured in the country. The indigenous salt industry was in a depressed state in spite of the grant of protection to it in 1931, while imports of salt were going up.

One of the first measures of tax reform undertaken by the Government of India after achievement of Independence was the abolition of the tax on salt at a cost to the Exchequer of about Rs. 10 crores. Rightly or wrongly, the salt duty had come to be regarded as a symbol of Imperialist domination over the Indian masses. Its abolition, though welcome from a sentimental point of view, created for the Government the problem of discovering new sources of revenue. The cotton excise duty, re-introduced in 1949, more or less filled the same need as the salt tax did, though the question could be raised whether a tax on cloth was in any way more justifiable than a tax on salt.

The revenue from the sale of opium occupied an important place in the

finances of the East India Company. For many years the yield from this source was next only to the yields from land revenue and transit duties. With the abolition of transit duties after 1836, opium advanced to the second place next only to land revenue.

The monopoly in opium was inherited by the East India Company from the Mughal rulers. At first the rights of cultivating poppy (the source of opium) were farmed out to the Company's officials or their nominees. Later, in 1785, a system of public bidding was introduced. in 1799 the administration of the opium monopoly was placed directly under an official of the company. From time to time proposals came up to lift all restrictions on the manufacture and sale of opium and to secure revenues for the government's use with the help of an export duty, since most of the opium produced was sold to China. But apart from leading to minor changes in administrative procedures, these proposals had little effect. On the eve of the transfer of power from the Company to the Crown in 1858, the Company was obtaining nearly £5 million per year from this source.

The precariousness of the revenue from opium was stressed by several Finance Members. As soon as the demand from China would fall off, this source of revenue would disappear. There were also years of shortfall in the domestic crop and the consequent drop in revenues. Towards the end of the nineteenth century competition from Persian opium in the Chinese market also created some problems for Indian revenues. Domestic production in China was also expanding, but owing to its inferior quality Chinese opium offered little threat to the Indian product.

The unethical nature of the revenue from opium also struck official spokesmen from time to time. But the duty of suppressing the opium habit, it was felt, rested with the Chinese government. Even if the Indian government abandoned its monopoly of opium, private traders would surely enter into its production and trade and enjoy profits so long as Chinese demand for Indian opium remained unchanged. There was no reason, in the existing circumstances, why the Government of India should forego the revenues from opium.

When the Royal Commission on Opium investigated the opium question in 1893, the annual revenue from this source was nearly Rs. 6 crores. The Commission did not agree with the view that the production and sale of opium should be confined only to medical uses. It held that India could not afford to sacrifice the revenue from opium sold to China, but recommended that more restrictions should be imposed on consumption of opium inside India.

By the opening years of the nineteenth century domestic production of opium in China had exceeded Indian opium sales to that country. The Chinese authorities were at this time considering measures for putting restrictions on opium consumption in that country. By issuing a proclama-

tion in 1906 the Government of China declared its intention to suppress the production and consumption of opium within a period of ten years. The Government of India was approached for help in the realisation of this programme and in 1907 a Sino-Indian agreement was signed through which India assured China of gradually reducing and finally putting a stop to her exports of opium to that country. Thus the Indian people were "called upon to make sacrifices in the interests of humanity." After 1913 sales of opium to China were discontinued. Exports to other Far Eastern countries continued for the time being. But in 1926 India accepted the League of Nations Convention regarding international trade in opium and agreed to stop all exports of opium, except for legitimate medical purposes, by the year 1935. The excise duty on domestic consumption of opium was yielding a revenue of about Rs. 1 crore per annum in 1949–50.

Direct taxes on certain trades and professions were sometimes levied by the East India Company's administration in the Presidency towns. But these taxes were usually poorly administered and the Company gave up their use as revenues from other sources looked up. After the Mutiny the financial crisis facing the Government of India was so serious that, in spite of the general reluctance to impose direct taxes and opposition from both Government officials and business interests, the government was obliged to levy a tax on trades and professions in 1859. This tax virtually amounted to a 3 per cent levy on all incomes below Rs. 2,000. But there was no system of regular assessment of incomes and, in some cases at least, the levy was discharged by means of a lump-sum payment without any reference to incomes earned by the assessees.

In 1860 James Wilson, the first Finance Member of the Government of India, proposed the introduction of two separate taxes closely related to each other: a Licence tax on traders with relatively small incomes and an Income tax. The tax on incomes was to be at the rate of 2 per cent for annual incomes between Rs. 200 and Rs. 500, and at 4 per cent for incomes above Rs. 500. Persons engaged in the cultivation of lands would not be liable to this tax unless the full annual value of their lands was at least Rs. 6,000 per annum. The Income Tax Act was adopted by the Legislative Council in July 1860. The novelty of the tax raised doubts, specially on the ground that the government might use the Act in a high-handed manner and institute a probe into private incomes. But since it was an emergency measure, likely to be repealed after five years, the income tax won the general approval of the upper-class assessees.

The Licence tax bill, after being stalled in the Legislative Council for over a year, was passed in July 1861. The assessees were divided into three groups and licence fees for the groups were fixed at Rs. 1, Re. 2 and Rs. 3 respectively. Altogether about 50 lakh people were affected by the Licence tax. Although this tax, like the Income tax, was intended to remain in

operation for five years, it was repealed in early 1862 when it was found that such a vexatious tax was uncalled for, particularly since the financial situation had improved since the passing of the Act.

In 1867 the Licence tax was re-imposed in a different form. Assessees were grouped into six classes and the tax on these groups varied from Rs. 4 (on a minimum annual income of Rs. 200) to Rs. 2,000, the highest rate being designed for joint-stock companies. The tax was financially successful, but as the minimum limit was rather low, this was raised to Rs. 500 by an amendment in 1868. The burden of the tax was eased by a revision of the rates as well.

Meanwhile, the Income tax rates were also revised and incomes between Rs. 200 and Rs. 500 were altogether excluded from the scope of that tax. As mentioned earlier, the income tax had been introduced as a temporary measure and, in spite of the difficulties of giving up a source of revenue which yielded nearly £1.5 million every year, the income tax was abolished in July 1865.

A few years later, faced with successive deficits in its budget, the Government of India decided, in 1869, to convert the Licence tax adopted in 1867 into an Income tax proper, although it was not intended to rely on any detailed assessment of individual incomes. The tax rates were based on a rough-and-ready assessment, the minimum exemption limit was Rs. 500 per annum, and the average incidence was 1 per cent on incomes. Incomes from landed estates were included for the purpose of assessment.

The rate of income taxation was revised upwards in 1869 and again in 1870. On the latter occasion individual assessments were introduced and submission of returns by tax payers became obligatory. The rates fixed in 1870 (3.8 per cent on the average) were probably too high, and the yield from the tax fell below expectation. Next year the rates were lowered to an average of slightly above 1 per cent, while the minimum exemption limit was raised to Rs. 750 per annum. In 1872 the taxable minimum was raised to Rs. 1,000. Throughout this period the debate over the desirability of continuing the income tax was going on. With the improvement of financial conditions in 1873 the Income tax was abolished. Lord Northbrook, the then Governor-General, took the initiative in this matter although his Finance Member, Sir Richard Temple, would prefer to remit other taxes and keep the income tax unchanged. In Sir Richard Temple's view the income tax was the only tax that fell on the rich and was useful in mitigating the burden that otherwise fell on the poor. Another member of the Governor-General's Executive Council, Mr. B.H. Ellis, lamented that the budgetary surplus had not been used to abolish the salt duties which were such a great burden on the poor.

When the government's financial conditions deteriorated again in the latter part of the 1870s, largely because of a series of famines in different

parts of the country, measures to augment revenues had to be devised again. Licence taxes were revived during 1877–78 in almost every Indian Province. The classification of assessees varied from one Province to another, but everywhere the licence fee was graded according to the nature of the trade or profession, the latter being grouped according to income most likely to be earned by a representative person following that profession. The maximum and minimum fees payable were different in different Provinces; the minimum could be as low as Re. 1 and the maximum could go up to Rs. 800. Persons with annual incomes of less than Rs. 100 (higher in some Provinces) were usually exempted. This exemption limit was considered rather low and was raised in 1880 to Rs. 500. But the most iniquitous feature of the Acts was the discrimination made between different groups of income earners. While persons following one of the trades listed in the Acts were liable to taxation, others enjoying similar incomes in occupations outside the scope of the Acts were exempted. Moreover, the variations in the system of Licence taxes among the Provinces and the changes introduced from time to time in the rates of such taxes and systems of administration were often without any rhyme or reason. The situation evidently called for a thorough reform of the direct tax system with a view to securing uniformity and a reasonable degree of certainty. An income tax was the only remedy in such a situation.

The Income Tax Act of 1886 grouped incomes into four categories, *viz.*, (*a*) salaries and pensions, (*b*) profits of companies, (*c*) interest on securities, and (*d*) income from other sources. Incomes below Rs. 500 per year were exempted. For categories (*a*) and (*c*), incomes between Rs. 500 and Rs. 2,000 were to pay taxes at about 2 per cent of income and incomes above Rs. 2,000 were to be charged the full rate of about 2½ per cent. For category (*b*) the tax rate was uniformly 2½ per cent. For category (*d*), specific amounts were fixed for income classes up to Rs. 2,000 per year, while incomes above Rs. 2,000 were charged at the full rate—2½ per cent. Incomes derived from land were not liable to income tax payments. For the first time it was provided that life insurance premiums or deferred annuities up to one-sixth of total income would be deducted from income and the tax liability would be computed on the reduced amount. With the passing of this Act the Licence Acts passed in the 1870s were repealed.

The income tax continued in this form until 1902-03. In that year the taxable minimum was raised from Rs. 500 to Rs. 1,000. This change reduced the number of assessees by more than half, but the loss of revenue was only marginal. The gross receipts from income tax fell by less than 15 per cent in the year following this change.

In the opening years of the twentieth century the income tax again came in for some bitter criticism. As this was a period of comfortable surpluses for the government, some members of the Indian legislature wanted that this tax should be given up. With a uniform rate for all incomes above Rs. 2,000

per year the tax was also being regarded as very un-even in its incidence. The demand for introducing more graduation in incomes liable to this tax was being increasingly voiced. The government, however, carried on with the existing system until the First World War broke out.

In 1916 the needs of war finance forced the government to raise the rates of income tax on incomes above Rs. 5,000 per year. Incomes of Rs. 5,000 and above, but below Rs. 10,000, were to pay about 3¼ per cent; incomes above that range, but below Rs. 25,000, were to pay about 4¾ per cent, and incomes of Rs. 25,000 and above were to pay 6¼ per cent. To check evasion, the provisions relating to submission of income tax returns were made more strict in 1917. In that year the ordinary income tax came to be supplemented by a super-tax which was chargeable on incomes above Rs. 50,000. The rates fixed for super-tax were: 6¼ per cent for incomes up to Rs. 1 lakh, about 9½ per cent[4] for incomes up to Rs. 1½ lakh, 12½ per cent for incomes up to Rs. 2 lakh, about 15¾ per cent for incomes up to Rs. 2.5 lakh and 18¾ per cent for incomes above Rs. 2.5 lakh.

In 1918 the government came out with a proposal to include agricultural incomes for the purpose of determining the rate at which 'taxable' income would be liable to pay the income tax. This was taken by the landlord class as a challenge to their right of enjoying their agricultural incomes undisturbed, as had been intended by the makers of the Permanent Settlement. Although agricultural income as such was not proposed to be taxed, the landlords considered that such a provision in the Income Tax Act would be the 'thin end of the wedge' that would ultimately extend the scope of the income tax to agricultural income as well. Their opposition stalled the passage of the amending Act.

In 1919 the minimum exemption limit of taxable income was raised to Rs. 2,000 in view of the fact that the value of money incomes had fallen sharply as a result of the war. At the same time the government sought to raise additional resources by imposing an Excess Profits Duty on companies earning profits exceeding Rs. 30,000 per year. The E.P.D. was to be in lieu of the super-tax. The excess profits were to be computed as the excess of profits earned over a *standard* profit, the latter being an average of the profit earned during the two pre-war years and the first two years since the commencement of the War. The rate of tax on the excess profit thus defined was to be 50 per cent.

Owing to the opposition of the business community the E.P.D. was abandoned in 1920 and was replaced by an amended super-tax at the flat rate of 1 anna per rupee (6¼ per cent) on the income of companies. With this change in the form of company taxation, India can be said to have introduced the 'Corporation tax' in effect, though not in name.

The rates of income tax and super tax were revised upwards in 1921

4. The rates were actually expressed in annas per rupee.

and again in 1922. In the latter year the provisions relating to the income tax were consolidated on the basis of the recommendations of the All-India Income Tax Committee set up in 1921. The income tax administration was put under a newly constituted Board of Inland Revenue (later called the Central Board of Revenue) under which there was to be a Commissioner of Income Tax in every Province. The practice of making employers liable for collecting the income tax due from their employees was introduced by the Income Tax Act of 1922.

The Taxation Enquiry Committee (1924-25) gave considerable attention to the improvement of the income tax administration. Some of its recommendations were made into law by amendments to the Act of 1922 during 1926-29. The exigencies of the Depression made a further enhancement of income tax and super tax rates unavoidable in 1930-31. The minimum exemption limit was lowered to Rs. 1,000 towards the end of 1931. At the same time a temporary surcharge was introduced on all income tax payments.

As the economic situation improved, the rates of surcharge were lowered and some rates, specially on lower income ranges, were brought down after 1933. In 1936, the minimum limit for taxation was again raised to Rs. 2,000. By the Income Tax Act of 1939 the surcharges were totally abolished and the 'slab' system of taxation was introduced to replace the previously current 'step' system.[5] At the same time the exemption limit was reduced to Rs. 1,500.

As the Second World War created huge demand for additional finances, the Government of India introduced in 1940 an Excess Profits Tax to be levied at 50 per cent of profit in excess of a standard, the latter being taken as the profit for any year between 1935-36 and 1939-40 at the assessee's option. E.P.T. was applicable only to firms earning Rs. 30,000 and above in any year. The levy of a 25 per cent Central surcharge on all income and super taxes was another war-time measure introduced in the latter part of 1940. In 1941, the E.P.T. rate was raised to 66 per cent and the Central surcharge on income and super taxes to 33⅓ per cent. The surcharge was raised further in 1942 and 1943. In 1944 the income tax exemption limit was raised again to Rs. 2,000. In 1945, for the first time, different rates for 'earned' and 'unearned' incomes were introduced in the Indian income tax system.

After the Second World War, in 1946-47, the war-time surcharges were amalgamated with the basic rates. At the same time some relief was given to low income assessees. The merging of the surcharges with the basic rates implied that the Central Government's relative share in the income tax proceeds would be smaller than before, while the Provincial finances would be correspondingly benefited.

5. This had been recommendet in 1935 by a Committee set up to make a comprehensive review of the Indian Income Tax.

The 1947–48 budget raised the minimum taxable income to Rs. 2,500. In the next budget this was raised to Rs. 3,000. Several other measures of relief were simultaneously introduced for the lower-income groups in consideration of the inflationary pressure that had intensified since the end of the war. In 1950 the exemption limit was raised once again to Rs. 3,600 for individuals and to Rs. 7,200 for undivided Hindu families.

Between 1946 and 1950 a number of 'incentive' measures were adopted as a part of income tax legislation to encourage private development expenditure and full utilisation of existing industrial capacity. Special depreciation allowances at 20 per cent of value on new plant and machinery, tax exemption for two years on new buildings constructed between 1946 and 1952, extra depreciation allowances of up to 100 per cent on plant and machinery being worked on a three-shift basis, exemption of profits up to a limit of 6 per cent on capital for new industrial ventures for an initial period of five years—these were some of the provisions written into the Finance Acts during the immediate post-Independence period, thus making the income tax an important instrument in the government's toolbox of policies for speeding up economic development.

The Excess Profits Tax introduced in 1940 was somewhat hastily taken off in 1946. In the budget for 1947–48 the Finance Minister proposed to introduce in its stead a special Business Profits Tax at the rate of 25 per cent on all business profits exceeding Rs. 1 lakh in a year. This was strongly opposed by representatives of business interests in the Central legislature. A compromise was reached by which the tax rate was reduced to 16⅔ per cent and the taxable profits were to be arrived at by exempting 6 per cent on the capital at charge or Rs. 1 lakh, whichever was greater. In 1949 the tax rate was reduced to 10 per cent and the exemption limit was raised to Rs. 2 lakhs. This tax was a temporary measure intended to soak off the excessively high profits of the immediate post-war period. Accordingly, it was withdrawn in 1950.

A new type of direct tax, the tax on capital gains, appeared in the Indian tax system for a short while between 1947 and 1950. The exemption limit was Rs. 15,000. But the tax, if it was intended to capture for the State some of the gains from capital transactions at inflated prices during the war and post-war period, came rather too late. Almost immediately after its imposition capital values started declining and the expected yield from the tax did not materialise. In 1949–50 the tax was therefore abolished, the loss of revenue being nearly Rs. 1 crore.

The income tax yielded in 1886–87 a sum of Rs. 1.28 crores. Just before the First World War it had been contributing about Rs. 3 crores to Central revenues. The changes in the provisions of income taxation and improvement in tax administration after 1918 raised the yield from this tax to Rs. 18.5 crores in 1923–24. On the eve of the Second World War income taxes (including the tax on company profits) were yielding over Rs. 19

crores (1939-40) of which the Provincial share was Rs. 2.8 crores. The Second World War and the post-war period saw further modifications in income tax law and administration. The yield from the income taxes (including the Business Profits and Capital Gains taxes) rose in 1950-51 to Rs. 173 crores of which the States' share was Rs: 46.97 crores. The income taxes contributed about 3 per cent to the Government of India's tax revenues in 1903-04, about 12 per cent in 1923-24, 20 per cent or so in 1939-40 and nearly 33 per cent in 1950-51.

Apart from the 'countervailing' excise duty on cotton cloth mentioned earlier and taxes on salt, opium, motor spirit, kerosene and intoxicating drugs and liquors, there were no other taxes on domestic manufacture of commodities before 1934. The Government of India's revenue from customs duties had considerably declined after the adoption of a policy of protection in 1924 and the onset of the world-wide depression in the 'thirties. To make up for this loss of revenues the Government of India introduced in March 1934 two excise duties on sugar and matches. After the sugar industry received protection in 1932 domestic production of sugar had considerably expanded at the expense of imports. The excise duty on sugar was intended both to make good the loss in respect of import duties and to curb an unhealthy expansion in domestic sugar-producing capacity. The excise on sugar reduced to some extent the effectiveness of the protection granted to the home industry, the government claiming that the protective duties were excessively liberal. In the case of matches, however, the excise was accompanied by an enhancement of the import duty intended to keep the quantum of protection unchanged. An excise duty on steel ingots, also introduced in 1934, was similarly matched by a countervailing import duty. In 1937, when the excise duty on sugar was nearly doubled, the import duty was revised upwards so as not to reduce the effectiveness of the protective duty.

Excise, as a source of revenue, came to be cultivated more intensively during the Second World War. The existing duties were sharply increased, while newer commodities subjected to excise included tobacco, tyres and tubes, hydrogenated vegetable oils (Vanaspati), betel nuts, tea and coffee. Cotton cloth came to be subjected to excise in 1949. While superfine and fine cloth paid duties at 25 per cent and 6¼ per cent *ad valorem*, medium and coarse cloth was subjected to a specific duty of ¼ anna per yard. Such tax on ordinary clothing was justified on the ground that every citizen should pay at least a token tax. With the abolition of the tax on salt this aim was to be realised through a small tax on coarse cloth. The duty was, however, confined to cloth turned out by the factories. Hand-woven cloth was thus given an opportunity to survive the competition from the mills. Similar discrimination in favour of cottage match factories has existed since 1941.

The excise duties imposed by the Central Government yielded a sum of about Rs. 8.7 crores on the eve of the Second World War (1938–39). In 1950–51 the yield from Union excise duties rose to Rs. 67.5 crores. While in 1938-39 only about 11 per cent of Central tax revenues came from the excise duties, in 1950-51 they formed almost 17 per cent of such revenues.

In 1950–51 out of a total tax revenue of Rs. 357 crores accruing to the Central Government direct taxes contributed nearly Rs. 127 crores (36 per cent). On the eve of the Second World War direct taxes yielded only about 22 per cent of Central revenues.

Provincial (State) Finances

Indian Provinces did not have any sources of revenue specifically assigned to them by law until the Government of India Act, 1919 introduced a system of limited Provincial autonomy. Under this new dispensation, revenue sources placed under Provincial jurisdiction were: Land revenue (including irrigation charges), stamps (judicial as well as commercial), registration fees, excises on liquors and narcotics, taxes on betting, gambling, amusements and advertisements, succession duties and the income from forests and minerals. The Provinces were also to receive a share of the income tax collections at the rate of three pies per rupee of the additional tax collection in any year over the amount collected in 1920–21. For the purposes of local administration the Provinces could also introduce, or allow local self-governing bodies to introduce, taxes on buildings and land values and on motor vehicles as well as charges like tolls and *octroi*.

Land revenue remained the main prop of Provincial finance, yielding not less than 40 per cent of total Provincial revenues until the Second World War. Excise on liquors and narcotics was usually the next most important item, followed by revenue from the sale of stamps and registration fees. Betting and amusement taxes, introduced in a number of Provinces after 1921, produced very little by way of revenues.

The Constitutional Reforms of 1935 conferred on the Provinces the right to impose taxes on sales of goods and on trades, professions and employment in addition to the financial rights enjoyed earlier. In the hands of the newly elected Provincial governments, elected on a wider franchise than before, Provincial taxation was expected to acquire a new dynamism intended to generate additional financial resources for the 'nation-building' activities. Nothing like this happened, however. Some taxes imposed by the new Provincial Ministries, such as taxes on urban immovable property, were invalidated by legal decision. Taxes such as those on employment and the professions came into conflict with the income tax and were therefore used only within limits. Only the sales tax had a freer scope and succeeded, after an initial period of difficulties, in collecting for the

Provincial governments a fairly large revenue. Some Provinces, however, had to forego their excise revenue as a result of implementing a policy of 'prohibition' of open sale of liquors. Consequently aggregate Provincial revenues did not increase appreciably over the period 1937–40. With the coming of the Second World War Provincial revenues began to improve until by 1945-46 they stood at $2\frac{1}{4}$ times the pre-war (1939–40) level. The general sales tax played an important role in this expansion of Provincial revenues.

The sales tax first came to be introduced by the Central Provinces Government in the form of a levy on the retail sale of motor spirit and lubricants at 5 per cent of sale price. The reason why this group of commodities first attracted the sales tax lay in the organisation of the sales of this commodity which was controlled by relatively few foreign oil companies. This facilitated assessment and collection. The tax was also approved on general grounds since it was supposed to be collected from the more affluent sections of the population. As this tax came to be adopted in other Provinces, too, there developed a disparity in rates which has not been remedied even today.

A 'general' sales tax on a large number of articles was imposed in 1939 by the Government of Madras. During the period 1941–48 the tax spread to the other Provinces as well. In some Provinces the single-point tax method was adopted, the tax being collected only at the retail stage. Some other Provinces, however, adopted the multi-point tax method under which the same article was to pay tax, at relatively lower rates, in several stages as it passed from the manufacturers to wholesalers, from wholesalers to retailers and finally from retailers to the ultimate customers. Usually essential articles were exempted from the tax and dealers with a small turnover were also left outside its scope. But the Provinces have not followed any uniform principles regarding either exemptions or rates of taxation. Conflict with the Centre is also a problem of considerable significance, since the same article may be subjected both to a Central excise duty at the manufacturing stage and a Provincial sales tax at the selling stage.

By 1950–51 sales taxes had replaced land revenue as the most important source of Provincial revenues. In that year out of Rs. 269.6 crores accruing to the States by way of taxes, sales taxes had been responsible for a yield of over Rs. 55 crores, land revenue for about Rs. 50 crores, State excises for Rs. 47 crores and stamps for Rs. 22 crores. But revenue sources earmarked for the Provincial governments were coming to be over-shadowed by taxes which the Centre shared with the States and by grants-in-aid from the Central Government which were being assigned a bigger and bigger role under the schemes relating to inter-governmental financial relations evolved during 1937–50.

Inter-Governmental Financial Relations

In the early days of the East India Company's reign the finances of the three Presidencies—Bengal, Bombay, and Madras—were kept completely separate. Bengal usually enjoyed a revenue surplus, while Bombay and Madras ran deficits in most of the years. Accordingly 'investments' in these two Presidencies had to be financed by the surplus territorial revenues of Bengal.

When the East India Company was deprived of its trading functions in 1833, it became a purely administrative body supervising the Indian Empire on behalf of the Crown. Finances of British India were centralised in the hands of the Governor-General of India and his Council. Provincial governments were made completely subordinate to the Centre and had neither independent powers of taxation nor powers of sanctioning additional expenditure without Central approval.

This excessive centralisation of financial powers naturally made Provincial administration wasteful and irresponsible. Levels of expenditure in the different Provinces were determined less by needs than by the skill of the Provincial Governors in pleading their cases with the Central authorities. As so often happens in such circumstances, the more extravagant a Province was, the more expenditure it could get sanctioned for the next financial year. The system provided little incentive to the Provinces to avoid inessential expenditures. In fact, Provincial demands for additional finances were responsible for recurrent deficits in the Indian budgets during 1860–70.

With the assumption of administrative powers by the Crown in 1858 the unsatisfactory nature of the financial relations between the Central and Provincial governments came to be realized and schemes began to be formulated to make the Provinces more self-reliant in respect of financial matters. Mr. William Massey, the third Finance Member in the Government of India, submitted a proposal for the devolution of financial powers to the Provinces which, if accepted, would have been the first scheme of federal finance in British Indian administration. Under this set of proposals Provincial governments were to have independent taxing powers and be the final spending authority in respect of certain subjects like Education, Health, Police services, Jails and Registration. In addition, Provincial governments were to receive one anna in the rupee out of land revenue collections and 25 per cent of the net receipts from the income and licence taxes. Mr. Massey's scheme, however, was premature in the sense that centralizing tendencies were still too dominant in the Indian administrative set-up. Both the Governor-General and the Home authorities were opposed to the idea of making the Provinces independent of the Centre.

A more modest scheme, approved by the Governor-General, Lord Mayo, in December 1870 came to be adopted from 1871 with a view to

curb the extravagance of the Provincial authorities. Certain services of a local character (Education, Medical Services, Police, Jail, Registration, Roads, Civil Buildings, Public works, etc.) were declared as exclusively Provincial and departmental receipts under these heads were to accrue henceforth to the Provinces. Central financial assignments (called 'Provincial Settlements') for such services were unalterably fixed for five years at a time, so that additional expenditure under these heads could be incurred only by imposing local taxation with Central approval. Besides, the Provinces were entitled to borrow from the Centre under the Local Loans Act, 1871.

This first scheme of financial de-centralization was widely hailed at the time as the "Charter of Provincial Governments". In fact, however, the Provincial governments' power to spend was severely circumscribed by such a measure, particularly when no elastic sources of revenue were placed at their disposal. The only method used by them was to impose local 'cesses' on land revenue putting additional burdens on the agricultural classes. Moreover, in drawing up the list of Central financial assignments to the several Provinces no attention was paid to relative needs. The assignments for 1870--71 were taken as the basis for the devolution and, consequently, existing inequities were made permanent.

The next stage in financial decentralization came in 1877 when some additional heads of expenditure such as Land Revenue, Excise, Stamps, Law and Justice and Central Administration were transferred to the Provinces. At the same time, certain heads of revenue such as Excise, Stamps, Law and Justice were also put at the Provincial governments' disposal. The demarcation of heads of revenue into Central and Provincial was undoubtedly a further step in the direction of federal finance, although it was still purely an administrative arrangement. But Central financial assignments in favour of the Provinces could not be dispensed with, since Provincial revenues were inadequate in relation to Provincial expenditure. The distribution of these assignments still lacked a principle. In two Provinces, Assam and Burma, Central grants were dispensed with by giving these Provinces a share in the land revenue and, in the case of Burma, also in the export duties on rice and salt and in the income from forests.

This scheme of shared taxes ('divided heads of revenue') was adopted on a general basis by Lord Ripon's government in 1882 when abolishing the Central financial assignments in favour of the Provinces. The heads of revenue were classified as follows: (*a*) Imperial --Opium, Salt, Customs, Commercial Undertakings, etc.: (*b*) Provincial—Civil Departmental Receipts, Receipts from Provincial Works and Provincial Rates, (*c*) Divided—Excise, Stamps, Forest, Registration, Land revenue. These arrangements were to remain in force for five years at a time. This system, with minor modifications, continued until 1919. The five-yearly revisions being responsible for a good deal of uncertainty, the arrangements were declared as

semi-permanent by Lord Curzon's government in 1904 which implied that the arrangements would be revised only in very special circumstances. Subsequently on the recommendation of the Royal Commission on Decentralisation (1907) the Provincial Settlements were declared as permanent for all practical purposes under Lord Hardinge's Viceroyalty in 1912. During famines Provinces could seek aid from the Centre while they undertook to help the Centre financially if a war broke out.

On the eve of the First World War and up to the Reforms of 1919 the heads of revenue were divided as follows. Revenues which could not be traced or attributed to any particular Province, such as Customs, Salt, Opium, Railways, Posts and Telegraphs, etc., were regarded as Imperial Heads of Revenue. Departmental receipts from Provincial subjects like Education, Law and Justice and receipts from Forests and Registration were regarded as Provincial Heads of Revenue. Land Revenue, Income-Tax, Irrigation charges, Stamps and Excise (except in Bombay and Bengal where it was a wholly Provincial receipt) were the Divided Heads of Revenue. This last category was shared between Central and Provincial governments, the relative shares being determined Province-wise, but usually there was a 50 : 50 division. The problem of Central interference with Provincial finances continued so long as certain sources of revenue remained shareable between the Centre and the Provinces without any determinate principle of sharing. Moreover, Central surpluses used to be doled out, even under this system, to the Provincial governments and the distribution of such doles caused much heart-burning among the Provinces. It may be noted also that though certain sources of revenue had been assigned to the Provinces, the Provincial governments had no independent legal powers of taxation or borrowing. They had to submit to the control of the Central Government in almost all financial matters. The Centre did not permit the Provinces to budget for a deficit or to use their surpluses in the way they liked.

Under the Government of India Act, 1919, Provincial governments enjoyed for the first time a considerable extent of financial autonomy. The Divided Heads of Revenue were abolished. Provincial governments were given almost complete authority in respect of the Provincial Heads of Revenue which included Land Revenue, Irrigation charges, Stamps (judicial as well as commercial), Excise and Registration. A small share in the income tax collections was, however, to accrue to the Provinces, but only if income assessed to the income tax rose above the level of 1920-21. For each rupee of additional income assessed, the Provinces were to receive three pies. This arrangement was introduced at the last moment to keep up the Provincial governments' interest in improving income tax collections as well as to minimise the loss of revenue to industrial Provinces like Bengal and Bombay which would have suffered heavily from the complete centralization of the proceeds from the income tax, as recommended by the

Financial Relations Committee under Lord Meston set up in 1920.

The financial arrangements introduced after the abolition of Divided Heads of Revenue were estimated to leave the Central Government with an annual deficit of Rs. 9.83 lakhs. This deficit was to be filled up by a system of Provincial 'contributions' to the Centre. The Meston Committee prepared a scheme for such contributions. The 'initial' contributions for 1921–22 were more or less arbitrarily fixed taking into account only the increased spending power that had accrued to the Provinces. These were subsequently to be replaced by the 'standard' contributions fixed on the basis of Provincial population, income tax collections, consumption of salt and textiles, agricultural and industrial wealth, etc. The transition from the 'initial' to the 'standard' contributions was to be effected gradually over a period of seven years.

The financial arrangements outlined above were put into effect through the Devolution Rules issued under the Government of India Act, 1919. The arrangements could not satisfy the more prosperous Provinces like Bengal and Bombay which received only minor compensation for the loss of their share in the divided heads of revenue. At the same time, some of the relatively depressed Provinces found that their 'initial' contributions under the Meston Award had been fixed at too high a level to leave them any sizeable surplus for nation-building work. To add to this discontent, deficits began to emerge in the Provincial budgets soon after the scheme of contributions had been introduced and the Meston contributions came to be regarded as the factor responsible for such deficits. Faced with growing criticism from the Provinces the Government of India remitted a part of the contributions in 1925-26 and 1926–27. In 1927-28 the contributions were wholly suspended and in 1929 the scheme was declared as abandoned.

The abolition of Provincial contributions did not end all controversy, however. The distribution of revenue sources between the Centre and the Provinces was itself a target of attack. Under this scheme of distribution elastic sources of revenue like the customs, income tax, etc., had been placed under the Central government, while the relatively inflexible sources like land revenue remained under the Provincial governments. The Provincial governments were not in a position to spend additional funds for development as long as their resources position remained so inflexible. It should be added, however, that most of the Provincial governments showed a marked disinclination to utilise fully the new taxing powers which had been put at their disposal by the new Reforms.

The financial scheme accompanying the Government of India Act, 1935 aimed therefore at making the Provinces financially more capable of shouldering the responsibilities of Provincial administration. The subject was a matter for several investigations between 1929 and 1935. The Simon Commission, appointed in 1929 to report to the British Government on the next instalment of Constitutional progress in India, submitted its scheme for

financial reforms prepared by Sir Walter Layton, the Financial Assessor on the Commission. In 1931 the Federal Finance (Peel) Sub-Committee of the Round Table Conference laid down certain general principles regarding the financial arrangements to be introduced under the coming Reforms. The Federal Finance (Percy) Committee of 1932 also dealt with the issue and recommended the allocation of a substantial share of income tax proceeds to the Provinces. The Joint Select Committee of the British Parliament set up in 1933 to discuss the new Indian Constitution also dwelt at length with inter-governmental financial relations in the Indian context. The financial provisions of the Government of India Act, 1935 were drawn up on the basis of these deliberations.

The Act of 1935 put certain financial resources in the Federal Legislative list over which the Federal legislature was to have exclusive jurisdiction and other resources in the Provincial Legislative list over which Provincial legislatures were to have exclusive jurisdiction. The former list included customs, excise (excluding duties on liquors, opium, drugs and medical and toilet preparations), income taxes excluding taxes on agricultural incomes, corporation tax, taxes on capital values of assets excluding agricultural land, duties on succession of property other than agricultural land, stamp duties on certain commercial documents, the salt tax, taxes on railway fares and freights and terminal taxes on goods or passengers carried by railway or air. The net proceeds of some of these Federal taxes were, however, to be assigned to the Provinces--for example, succession duties, terminal taxes and stamp duties. In the case of the income tax also a prescribed percentage of the net proceeds was to be assigned to the Provinces. The proceeds of the salt tax, any of the excises, or export duties could also be assigned, in full or in part to the Provincial revenues. The Centre could impose a surcharge for its own purposes on any of the taxes assigned to the Provinces.

The Provincial Legislative list in 1935 contained the following revenue sources: land revenue, excise on liquors, drugs, opium and medicinal or toilet preparations, agricultural income taxes, agricultural capital taxes, succession duties in respect of agricultural land, taxes on mineral rights, capitation taxes, taxes on trades, professions and employment, taxes on animals and boats, taxes on amusements, betting and gambling, stamp duties other than those enumerated in the Federal list, tolls and *octroi*. Jute-growing Provinces (Bengal, Bihar, Assam and Orissa) were to receive 50 per cent or more of the net proceeds of the export duties on jute and jute products depending on the amounts of jute grown in each Province. Provinces which might be in need of further financial assistance were to receive grants-in-aid from the Centre.

Sir Otto Niemeyer, a financial expert from England, was appointed in 1936 to make recommendations regarding the distribution of the taxes whose net proceeds were to be distributed among the Provinces as well as

of the grants-in-aid to be provided to necessitous Provinces. He was also required to make a review of Provincial liabilities to the Centre. The Niemeyer Report was submitted to the Secretary of State for India in April 1936. In his Report Sir Otto pointed to the need for safeguarding the financial stability of the Centre while meeting the reasonable needs of the Provinces. He also took a good deal of care to "maintain a reasonable adjustment of the relative burden among the different Provinces and the Centre." In respect of the income tax, he recommended that 50 per cent of the net proceeds of this tax should be assigned to the Provinces. So far as distribution among the Provinces was concerned, he took both relative population figure and the residence of income tax assessees into account and arrived at the following percentages:

Bengal	20
Bombay	20
Madras	15
U.P.	15
Bihar	10
Punjab	8
C.P.	5
Assam	2
Orrisa	2
Sind	2
N.W.F.P.	1
	100

He recommended, however, that the Centre should not distribute the Provincial governments' share of the income tax for the first five years or until the sum of the portion retained by the Centre together with the contribution from railway revenues reached Rs. 13 crores, whichever was earlier. This stipulation, intended to consolidate the Centre's financial strength in a period of unbalanced budgets, was naturally resented by the Provinces. Under the Niemeyer scheme the Provinces were to receive their full shares of income tax proceeds only 10 years after the introduction of the scheme. The Provinces, however, began to receive some share of the income tax proceeds from 1937–38 onwards.

Regarding the proceeds of the jute export duty to be assigned to jute growing Provinces the Niemeyer Award suggested that 62½ per cent of the net proceeds should go to the jute-growing Provinces. The following Provinces were to receive varying amounts of Central grants-in-aid, usually for five years in the first instance:

Assam, Orissa, Sind (for about 45 years at progressively decreasing amounts), U.P. and the North-West Frontier Province.

As regards Provincial liabilities to the Centre the Niemeyer Award recommended cancellation of such debts, when incurred before 1st April, 1936, in the case of several Provinces including Bengal. This afforded considerable relief to Provincial budgets, coming as it did at a time when the Depression had forced many a Province to run into large debts with the Centre.

The Niemeyer award satisfied neither the Central nor the Provincial governments. The former considered it as over-generous to the Provinces. The latter preferred their own claims, to additional resources with such arguments as they could marshall.[6] These representations generally went unheeded. The award was entirely accepted by the British Government and put into effect through an Order-in-Council issued in May 1936.

During the Second World War the Central government's financial needs mounted and the Niemeyer award had to be amended in 1940 to enable the Centre to retain a larger share of income tax proceeds without, however, reducing the amounts accruing to the Provinces. Except for this modification financial relations between the Centre and the Provinces continued to be governed by the terms of the Niemeyer award until 1947.

With Independence and the partition of the country a number of necessary changes were introduced in the financial arrangements without, however, abandoning the basic scheme underlying the Niemeyer award. The percentage share of the Indian Provinces in the divisible pool of income tax was re-assigned in 1948 as follows:

Bengal (West)	12
Bombay	21
Madras	18
U.P.	19
Bihar	13
Punjab (East)	5
M.P.	6
Assam	3
Orissa	3
	100

At the same time the Provinces' claim on the jute export duties was reduced to 20 per cent of net proceeds in consideration of the changes brought about by the partition.

6. For details, see Jathar, G.B. and Beri, S.G., *op. cit.*, Vol. II, p. 574 ff.

Criticism of this *interim* allocation led the Government of India to appoint Sir C.D. Deshmukh in November 1949 for framing a new scheme of distribution of the income tax proceeds and suggesting additional grants-in-aid for the jute-growing Provinces. The Deshmukh award, put into effect from 1950–51, assigned the following percentage shares to the Provinces:

Bengal (West)	13.5
Bombay	21
Madras	17.5
U.P.	18
Bihar	12.5
Punjab (East)	5.5
M.P.	6
Assam	3
Orissa	3
	100

These figures were arrived at by modifying the Niemeyer award to take account of the fact that 14.5 percentage units had been released as a result of the transfer of Provinces like Sind and N.W.F.P. to Pakistan and the partition of Bengal and Punjab. These released percentages were then re-allocated among the Provinces remaining in India, but compared to the Niemeyer award the Deshmukh award gave a slightly greater weightage to the relative population of the Provinces in framing its scheme of income tax allocation.

The sharing of export duties having been abandoned in the new Constitution of India (January 1950), the jute-growing Provinces became entitled, under Article 273 of the Indian Constitution, to special compensatory grants. Under the Deshmukh award, the following compensatory grants were fixed. West Bengal Rs. 105 lakhs; Assam, Rs. 40 lakhs; Bihar, Rs. 35 lakhs; Orissa, Rs. 5 lakhs. These grants were to continue for 10 years.

The year 1946–47 saw the inception of a system of development grants from the Centre to the Provinces. These grants were made from the capital budget of the Central government. Special grants in support of the Grow More Food Campaign, for Air Raid Precautions and for Civil Defence Schemes had been initiated earlier during the Second World War. After the partition of the country in 1947, special Central grants were also made available to several Provinces affected by the aftermath of the partition. Some Provinces received *ad hoc* grants for natural calamities as and when occasion arose. Development grants were drastically curtailed in 1948–49,

but grants under the G.M.F. campaign head were maintained. In 1950–51 Central grants to States for development purposes (including G.M.F. schemes) amounted to Rs. 3.8 crores only, while in 1946–47 such grants had reached a figure of over Rs. 13 crores. The dislocation of Central finances after the partition and the enormous influx of refugees had brought about this adverse turn in Central assistance to State finances.

The Constitution of India, adopted in 1949, broadly followed the pattern of the federal financial arrangements introduced under the Government of India Act, 1935. The financial powers of the Union and State governments were separately shown in the Union list and State list of subjects. To provide adequate financial resources to the State governments some of the taxes levied and collected by the Union government are being assigned, wholly or partially, to the States. Besides the Constitution has also provided for different types of grants from the Union to the States.

Union-State Financial Relations under the Constitution of India

An important feature of the Constitution of India, adopted in 1949, was that, besides a detailed specification of the financial powers of the Union and the States, provision was also made (under Article 280 of the Constitution) for the periodic review of Union-State financial relations by a Finance Commission. Once in every five years (or earlier, if necessary) a Finance Commission is to be set up to deal *inter alia* with (*a*) the principles of distribution of shareable taxes (*e.g.* personal income tax) between the Union and the States, (*b*) the principles on which the proceeds of such taxes should be allocated among the States, (*c*) the principles on which taxes that are wholly assigned to the States but collected by the Union (*e.g.* estate duty before its abolition in 1985) are to be shared by the States, and (*d*) the consideration on which the Union government is to make grants available to all or certain selected States under Article 275 of the Indian Constitution. The Finance Commission can be asked to go into other issues involving financial relations between the Union and the States in accordance with the terms of reference contained in the notification setting up the Commission.[7]

In the Indian Constitution taxing powers have been granted to both the Union and the States. But certain taxes, levied and collected by the Union for administrative convenience, are to be either wholly or partially assigned to the States. Thus it is possible to distinguish among the following five categories of taxes: (*i*) taxes which are levied, collected and retained by the

7. The Finance Commission in India is not a permanent body unlike, for example, the Commonwealth Grants Commission in Australia. This has made difficult the continuous monitoring of inter-government fiscal relations.

Union (*e.g.* duties on imports and exports), (*ii*) taxes which are levied and collected by the Union government, but are wholly assigned to the States (*e.g.* duties on succession to property other than agricultural land), (*iii*) taxes which are levied and collected by the Union Government but have to be partially assigned to the States either on the basis of a Constitutional provision (*e.g.* income tax) or of a law passed by Parliament (*e.g.* Union excise duties), (*iv*) taxes which are levied by the Union government but are collected and retained by the States (*e.g.* stamp duties), and lastly (*v*) taxes which are levied, collected and retained by the States (*e.g.* agricultural income tax, sales taxes, state excise, entertainment tax and others). The Finance Commission's work is almost exclusively concerned with the first three categories of taxes. But the Commission is also required to pay attention to States' tax revenues as a whole, since the emergence of deficits in the States' revenue budgets has to be prevented by either raising the States' share in Union tax revenues or giving additional revenue grants to the States.

The First Finance Commission was appointed in November 1951 and submitted its report in December 1952. It recommended an increase in the States' share of income tax collections from the existing 50 per cent to 55 per cent. The States' share was to be assigned to individual States on the basis of both population and collection of income tax within the State; 80 per cent of the proceeds was to be assigned on the basis of population and 20 per cent on the basis of collection. The Commission, in fact, made their own calculation and arrived at the percentage share of each State. Regarding the sharing of Union excise duties with the States, the Commission recommended that it would be wise to confine such sharing to only three commodities with relatively large excise yields. These commodities were tobacco (including manufactured tobacco), matches and vegetable products. The States' share in the excise revenue from these commodities was to be 40 per cent and each State was to receive its share according to the percentage share of its population in the States' total. After taking into account the tax revenues thus transferred from the Union to the States, the Commission found that 7 States would still be in revenue deficit. Hence grants-in-aid were recommended for these States. In addition, 8 States in which primary school enrolment was too low received specific purpose grants for raising the level of primary education.

The Second Finance Commission was set up in June 1956 and submitted its report in September 1957. It recommended a rise in the States' share of income tax from 55 to 60 per cent. In distributing this amount among the States population was given a greater weightage then before; 90 per cent of the income tax proceeds was allocated on the basis of population and 10 per cent on the basis of collection. In respect of States' share in Union excise duties, the number of excise duties to be shared between the Union and the States was raised to eight; the new commodities were sugar, tea, coffee, paper and vegetable non-essential oils. However, the States' share was

reduced from 40 to 25 per cent. This was distributed among the States almost wholly (90 per cent) on the basis of population, but suitable adjustments were made by using the remaining 10 per cent of the proceeds. In the mean time a scheme of levying 'additional' excise duties in lieu of sales taxes by States had been adopted for some goods of special importance, such as mill-made cloth, sugar and tobacco. The Second Finance Commission was asked to advise on the principles of distribution of such additional excise duties. The Commission recommended that while each State was to be guaranteed at least the amount of sales tax revenue which it was earning in 1956–57, any balance above this amount was to be distributed among the States on the basis of consumption corrected with reference to the population of the State. In practice, each State's share was worked out by the Commission. 'Revenue-gap' grants were recommended on a much bigger scale than before when it was perceived that the States' expenditure on revenue account was expanding faster than their tax and non-tax revenues. As many as 11 out of 14 States were adjudged eligible for such grants.

The Third Finance Commission was appointed in December 1960 and submitted its report in December 1961. The main reason why this Finance Commission was set up earlier than usual was that the recommendations of the Finance Commission ought to relate, as far as possible, to the same period as a Five Year Plan. The Third Finance Commission recommended that States should receive 66⅔ per cent, instead of 60 per cent, of the net proceeds of income tax. However, by the Finance Act of 1959 all income taxes paid by companies were treated as 'corporation tax' which was not shareable with the States according to the provisions of the Constitution. As a result the 'divisible pool' of income tax became smaller than what it would have been if such a revision had not been made. In distributing the States' share of the income tax among the several States greater stress was again laid upon collection; 20 per cent of the share was to be allocated on the basis of collection and 80 per cent according to population. The scope of sharing of excise duties between the Union and the States was widened. All commodities with an excise yield of Rs. 50 lakhs or more in 1960–61 were brought within the scope of shareable excise duties. The number of commodities on which excise duty was to be shared rose to 35 as a result.[8] But the States' share in the total proceeds was reduced to 20 per cent. The Commission argued that in distributing the States' share among individual states, not only should population be taken into account, but also the relative financial weakness of a State and the proportion of Scheduled Castes and Scheduled Tribes population in the State. The relative weightage assigned to each factor was not clear from the Commission's report, but the percentage share of each State was worked out by the Commission on the basis of these criteria. As regards distribution of the

8. The excise yield on motor spirits was utilised for grants and was not shareable.

proceeds from additional excise duties, the Commission recommended that the balance over and above the guaranteed amount[9] was to be distributed among the States in the same proportion as the increase in each State's revenue from sales taxes on other commodities. The Third Finance Commission was also called upon to assign the grants in lieu of the tax on railway passenger fares. Under the constitution this tax, introduced in 1957, was to be wholly assigned to States. But when this tax was given up in 1961, the loss of revenue to the States was required to be compensated by grants from the Union. Each State was to receive its share on the basis of the route mileage of railways in the State, which was the principle recommended earlier by the Second Finance Commission in respect of the distribution of the tax proceeds. Grants were recommended both with the broad objective of wiping out revenue deficits (in case of all States except Maharashtra) and with the specific objective of improvement of communications (to 10 States). This specific-purpose grant was to be financed out of the Union excise duty on motor spirit, about 20 per cent of whose proceeds was to be used for this purpose.

Notification announcing the appointment of the Fourth Finance Commission was issued in May 1964. The report of the Commission was submitted to the Government of India in August 1965. The share of the States in income tax revenues was raised to 75 per cent, particularly in view of the fact that the States had been deprived of their claims to the income tax on companies. The Fourth Finance Commission left unchanged the principles of distribution of the *inter se* distribution of the income tax share among the States. As per the Third Commission's Report, 80 per cent was to be distributed on population basis and 20 per cent on the basis of collection. All Union excise duties with a few special exemptions, including those to be imposed in the next five years, were recommended for sharing with the States who would continue to receive 20 per cent of the net proceeds of such taxes. In assigning to each State its share of such proceeds the Commission gave 80 per cent weightage to population and 20 per cent to an index of economic and social backwardness. This index was based on the per capita value added by manufacturing, the proportion of working population to the total population of the State and a few other factors. The Commission worked out in detail the percentage share of each State in both income tax and excise duty proceeds. For distributing the balance over the guaranteed amount in respect of additional excise, the Commission recommended that the share of each State should be in accordance with the proportion of its sales tax revenue to the total sales tax revenues in all the States, calculated as an average for the years 1961-62 to 1963-64. The Commission did not recommend any specific-purpose grants on the

9. As silk fabrics were also taken out of the States' sales taxes and subjected to additional excise duties, the guaranteed amount also rose to some extent.

ground that it was difficult to ensure in every case that the grants would in fact be utilised for the special purpose for which they were given. It was found that grants were needed by 10 out of 16 States then existing to close their revenue deficits. These general grants-in-aid received the Commission's approval.

The Fifth Finance Commission was set up in February 1968 and submitted its report in July 1969, so that its recommendations could be acted upon during the period of the Fourth Five Year Plan (1969–74). The Commission left the States' share of income tax revenues unchanged at 75 per cent, but recommended the inclusion of advance tax collections in calculating the amount to be shared. The Commission, however, recommended a modification in the formula for distributing this share among the States themselves. Instead of 80 per cent weightage to population, a 90 per cent weightage was recommended, while the remaining 10 per cent was to be distributed on the basis of assessment in each State, and not actual collection which was the basis so far followed. The sharing of Union excise duties was left more or less unchanged; certain special excise duties which had remained outside the scope of revenue-sharing were, however, included for the first time. As before, the share of a State was to be decided according to its population size (80 per cent) and relative economic backwardness (20 per cent). But in determining backwardness as many as seven criteria were taken into consideration. These were: the State's per capita domestic product, the size of the scheduled tribes population in the State, the number of factory workers per lakh of population, net irrigated area per cultivator, length of railways and surfaced roads per 100 square kilometres, the number of school-going children as a proportion of children in the school-going age and the number of hospital beds in the State per one hundred population. Among these indicators, again, two-thirds weightage was given to the shortfall in the State's per capita domestic product below the national average and one-third weightage to the other indicators. The calculations were made by the Commission and the percentage share of each State was indicated in its report. The Fifth Finance Commission also modified the system of sharing additional excise duty proceeds; equal weightage was given in its scheme to population and sales tax collection in the State. This Commission also did not advocate any specific-purpose grants. But 10 out of 17 of the States were considered eligible for 'revenue-gap' grants on the basis of their revenue and expenditure forecasts for the next five years.

The Sixth Finance Commission was set up in June 1972 and its recommendations were implemented with effect from the financial year 1974–75. Its recommendation in respect of the income tax was to raise the States' share from 75 to 80 per cent. No modification was made in the existing formula for the *inter se* distribution of the States' income tax share. With regard to excise duties, it recommended a further enlargement of the divisible

pool by inclusion of 'auxiliary' excise duties which the Union government had introduced very recently as a means of augmenting its own revenues. The share of the States, however, remained unchanged at 20 per cent of the net proceeds. The Sixth Finance Commission also pleaded for giving up the composite index of backwardness which was relied upon by the Fourth and Fifth Commissions to determine a State's relative share. It recommended using the State Domestic Product per capita as the single indicator of backwardness. Each State was to receive its share of Union excise duties partly (75 per cent) on the basis of population and partly (25 per cent) on consideration of economic backwardness as indicated by the per capita State Domestic Product. In the case of additional excise duties the previous system of setting aside certain guaranteed amounts was proposed to be given up. The whole of the net amount collected under this head was to be distributed among the States on the basis of population, production of the commodity within the State and the level of per capita State Domestic Product as an indicator of backwardness. The actual percentages were worked out by the Commission by using these criteria. The Sixth Finance Commission did not make recommendations for any specific-purpose grant. But in making certain general grants available to 14 States, it took into account the need for fortifying certain specific administrative and social services such as primary education, medical services and welfare of Scheduled Castes and Tribes. It recommended, therefore, that when a specific objective had been considered by the Finance Commission in recommending a grant, the same objective should not attract assistance from the Planning Commission as well. The over-lapping roles of the Finance Commission and the Planning Commission were creating complications every now and then in evolving satisfactory financial relations between the Union and the States. Grants under Article 282 of the Constitution of India ('public purpose grants') were usually made on the advice of the Planning Commission and were in use as a regular mode of financing Plan schemes. Some grants under this Article were also made available to the States at the discretion of various Ministries in the Union government.

The report of the Seventh Finance Commission, submitted in October 1978, led to several changes in the sharing of resources between the Union and the States. The States' share in the revenue from income tax was raised from 80 to 85 per cent. In the allocation of this share among the States, 90 per cent weightage was given to population. A considerable increase in the amount of shared revenues was achieved by providing that 40 per cent of the net proceeds of all Union excise duties (excluding additional excise duties) and 100 per cent of the duty on electricity (introduced in 1977–78) were to be assigned to the States. The basis for State-wise distribution of the duty on electricity was the amount of electricity generated in each State. The share of other excise duties was to be distributed among the

States on the basis of four considerations—population, inverse of per capita State Domestic Product, percentage of population below the poverty line and potential revenue-earning capacity—giving equal weightage to these factors. Distribution of the proceeds from additional excise duties was based on considerations of consumption in each State, but since reliable figures of consumption were unavailable, indirect methods were suggested. For sugar the average despatches to each State over a period of three years was taken as an indicator of consumption. For textiles and tobacco the average State Domestic Product over 1973–76 was taken into consideration. The relative share of each State and Union Territory was worked out by the Commission on the basis of these considerations. As regards grants-in-aid, the Seventh Finance Commission observed that grants should play only a marginal role in any scheme of transfer of resources; the bulk of the transfer should take the form of shares in the tax revenues accruing to the States. This was brought about by an enhancement of their share in Union excise duties. The Commission found, on the basis of forecasts of revenue and expenditure received from each State and modified by the Commission (to correct for under-estimated revenues and over-estimated expenditures), that 8 States would require grants for wiping out their revenue deficits.

The Seventh Finance Commission also made important recommendations relating to the outstanding loans of the States vis-a-vis the Union. The Union government's loans to the States were on the increase every year, partly because such loans were used to finance a substantial part of the States' Five Year Plans and partly because of the growth of non-Plan loans for relief in natural disasters or other purposes. It was recommended that loans advanced to States against small savings collections were to be converted to loans in perpetuity, so that only interest obligations would have to be met. The remaining loans were classified into productive, semi-productive and unproductive types. All unproductive loans outstanding on 31 March 1979 were recommended to be written off. The semi-productive loans were to be recovered in 30 equal annual instalments and were to be charged interest at 4.75 per cent. The productive loans were to be repaid in 15 equal annual instalments and would bear interest at 5 per cent.

The Finance Commissions have also been called upon to recommend how proceeds from wholly assigned taxes (e.g. estate duty) were to be allocated among the States. Up to 1978–79 the proceeds from estate duty were divided into two portions, according as such proceeds arose from immovable or movable property. The net proceeds from the duty on immovable property were distributed in the same ratio as the gross value of such property assessed in each State to the total value assessed in a particular year. The portion ascribable to movable property was distributed in proportion to population. The distinction between movable and immovable property was removed on the advice of the Seventh Finance Commission

and the distribution was based solely on the value of property assessed in each State.

In 1982–83 the States received from the Union government nearly Rs. 4,633 crores by way of tax shares (26.2 per cent of Union tax revenues), Rs. 3,382 crores by way of grants (21.8 per cent of the Union government's own revenues) and Rs. 6,041 crores as loans (45.5 per cent of the Union government's net capital receipts). Shares of Union taxes, taken along with Union government grants, accounted for about 38 per cent of the revenue receipts of State governments, while loans from the Union government (excluding special loans for clearance of State overdrafts on the Reserve Bank) constituted about 58 per cent of the States' capital receipts.

20

National Income, Price Movements and Real Wages

National income estimates prepared by official statistical agencies have been available in India only since 1948–49. Prior to this there were private investigations into national income, based on production data compiled by official agencies for their own administrative purposes. In general, such investigations neither used a comprehensive concept of national income nor applied the refined methods of modern statistics. The different investigations also lacked comparability, since investigators were not uniform in their definitions or in their approaches to the data available.

Since national income estimates have been based on production data and agriculture has always contributed the largest part of aggregate output, the reliability of national income estimates in India must be regarded as dependent on the accuracy of the data available for the yields of the principal agricultural crops. Until very recently such data have been collected and processed under conditions which detracted considerably from their dependability.[1] The national income estimates built on such data suffered from the same deficiencies as a result.

The earliest estimates of national income for British India are to be found in the various writings of Dadabhai Naoroji (1825–1913). In a paper on "Wants and Means of India" read before the Bombay Branch of the East India Association in 1870, Naoroji arrived at £300 million (Rs. 300 crores) as the value of aggregate national production for that year. Since the population of British India was taken by him as 150 million, his *per capita* income figure was Rs. 20 only. In two other papers presented in 1876 to the same Association his figure for aggregate production was scaled up to £340 million which, allowing for the increase of population in the intervening years, again gave him a *per capita* output of Rs. 20 only. When Naoroji published his well-known book *Poverty and Un-British Rule in India* in 1871, he took the year 1867–68 as his reference year for the preparation of a national income estimate. For that year his estimate of aggregate national production was Rs. 340 crores which gave a *per capita* production figure of Rs. 30.

Naoroji's estimate did not allow for incomes in the 'tertiary' sector.

1. See Mukerji, M., in *Economic History of India, 1857–1956*, ed. by V.B Singh (1965).

Even for the other sectors he relied on notional estimates; for example in one of his papers he took the gross value of agricultural output at eight times the land revenue. He did not distinguish clearly between the social output and the revenue receipts accruing to government so that, in some instances at least, he took the latter as identical with the former. In spite of these deficiencies his estimates were not to be lightly dismissed. They were at least good indices for the physical output of which the bulk (perhaps about 60 per cent) consisted in that period of agricultural output.[2]

In the 1880s there were two estimates, one by T. Richard in a paper read before the Institute of Bankers, London, in 1881 and the other by Major Baring, then Finance Member in the Governor-General's Executive Council, in 1882. Richard estimated the national product of British India as Rs. 223 crores which yielded a *per capita* income of barely Rs. 10. Baring's estimate resulted in an aggregate figure of Rs. 525 crores, and a *per capita* figure of Rs. 27.

In his book *'Prosperous' British India*, William Digby, a bitter critic of British economic policies in India, prepared an estimate of national income in British India for 1898–99. His figure, Rs. 428 crores, which yielded Rs. 18.9 *per capita*, raised a good deal of controversy which was joined at the highest level. Digby's methods were not very scientific and his estimate most probably left out important items of output. Lord Curzon, the Governor-General, himself controverted such half-baked estimates in 1901 by putting forth an estimate of his own at Rs. 675 crores which yielded a *per capita* income of about Rs. 30.

In an article published in the *Journal of the Royal Statistical Society* of England, F.J. Atkinson estimated the national income of British India for two periods separated by an interval of twenty years. For 1875 Atkinson arrived at a figure of Rs. 574 crores or Rs. 30.5 per head. His estimate for 1895 put the aggregate income at Rs. 877 crores with the *per capita* income at Rs. 39.5. Later investigators like Dr. V.K.R.V. Rao have pointed to elements of over-estimation in Atkinson's methods of analysing the crop-output data, specially in respect of his 1895 estimate.

Brief reference may also be made to two studies by E.A. Horne and R. Giffen relating to the years 1891 and 1903 respectively. Horne reached a *per capita* figure of Rs. 28 while Giffen's estimate yielded Rs. 30[3] (Rs. 900 crores in the aggregate). It is remarkable that, in spite of the relatively crude methods used by the several investigators, all of them arrived at almost the same *per capita* income figure. One can therefore say with some confidence that at the turn of the present century the *per capita* income of British India was not very different from Rs. 30.

2. See Datta, B., *The Evolution of Economic Thinking in India* (Calcutta, 1962).

3. Giffen's figure related to India as a whole, while Horne's estimate took account of the British Indian provinces only.

G. Findlay Shirras in his *Science of Public Finance* attempted to reconstruct India's national income figures for 1871, 1881 and 1901. He arrived at the figures Rs. 340 crores, Rs. 529.5 crores and Rs. 670.3 crores for the above three years respectively. Using the Census population figures he estimated that *per capita* income rose from Rs. 20 in 1871 and Rs. 27 in 1881 to Rs. 30 in 1901.

Among several national income estimates published by individual investigators in the first three decades of the present century, mention may be made of estimates by Vakil and Muranjan, Wadia and Joshi, Shah and Khambatta and V.K.R.V. Rao. Vakil and Muranjan's estimates for 1911–14 yielded a figure of Rs. 1,774 crores for the aggregate national income (including the Princely States) and Rs. 58.5 for the *per capita* income. Wadia and Joshi took the year 1913–14 as their reference year and reached an estimate of Rs. 1,087 crores for the British Indian provinces, yielding a *per capita* income of Rs. 44.5. Shah and Khambatta studied several periods both before and after the First World War. For 1921–22 they arrived at an estimate of Rs. 2,364 crores for the national income and Rs. 74 for the *per capita* income. V.K.R.V. Rao used more satisfactory methods than any of his precursors though he, too, had to proceed on the basis of a number of questionable assumptions. He built up two estimates, one for British India during 1925-29 and the other for India as a whole, including the Princely States, for the year 1931–32. In the former he estimated aggregate national income as Rs. 2,068 crores with the *per capita* income as Rs. 80. In the latter, which related to a period when prices had been severely depressed, aggregate national income amounted to Rs. 1,689 crores and per capita income to Rs. 62.

The national income and *per capita* income figures presented above were built up by using current prices. If some idea has to be obtained regarding the long-term movement of incomes and levels of living in the country these have to be expressed in some common set of prices. The National Income Committee in its First Report published in 1951 adopted the year 1948–49 as the base of the price index by which national income figures of other years were to be deflated. If the same convention is adopted in respect of past years, some price data available since 1861[4] enable us to express prices in all the years following 1861 as a fraction (percentage) of the 1948–49 prices. Using these price indices to adjust the available *per capita* income estimates, M. Mukerji depicts the following course of movement of *real* income between 1867-68 and 1931-32 (see next page).

This series brings out that over a period of about 65 years, in spite of periodical downturns, the *per capita* income perhaps increased roughly by about 40 per cent. It also deserves notice that the depression years in the early 1930s did not result in any deterioration in *per capita* income levels, in spite of the very sudden fall in agricultural prices.

4. See Mukerji, M., *op. cit.*, p. 682.

Year	*Per Capita income in 1948–49 Rupees*
1867–68 (Naoroji's estimate)	169
1875 (Atkinson's estimate)	172
1881 (Baring's estimate)	184
1895 (Atkinson's estimate)	178
1901 (Curzon's estimate)	149
1911–14 (Vakil & Muranjan's estimate)	231
1913–14 (Wadia & Joshi's estimate)	171
1921–22 (Shah & Khambatta's estimate)	154
1925–29 (V.K.R.V. Rao's estimate)	202
1931–32 (-Do-)	241

The study of national income continued to evoke researchers' interest right through the period up to 1950–51 when the first official estimates were made available. B. Natarajan studied India's *per capita* income for 1938–39 and 1949–50 and arrived at an estimate of Rs. 68.5 at current prices (Rs. 269 at 1948–49 prices) for the earlier year. D.N. Saxena's estimate for 1945–46 yielded a figure of Rs. 224 at currently prevailing prices (Rs. 337 at 1948–49 prices), indicating in some measure the economic expansion that the Second World War had brought about. Natarajan found that *per capita* income in 1949–50 stood at Rs. 229 (Rs. 221 at 1948–49 prices) while the National Income Committee's figure for the same year was Rs. 249.[5] It can perhaps be inferred that between the year 1945–46 and 1949–50 economic conditions had deteriorated and per capita income had declined. Of course, the comparability of the various estimates can be questioned on various grounds. But since so many different estimates are available and they point roughly to the same conclusions, one can say with some confidence that *per capita* income increased, though at a very small rate, throughout 1870–1950 whereas in the last four or five years of the period a reverse movement had set in after the relatively high rates of expansion recorded during the Second World War period. There is little evidence to uphold the contrary view that economic decline was continuous throughout the period of British Imperialistic control over India.

The above conclusions are also corroborated by the national income indices recently built up by three investigators attempting to study movements in India's national income over a long period starting roughly from the beginning of the present century. Arora and Iyengar[6] built up three series for studying long-term trends in national income. All the series disclose a rising trend up to 1938–39 and indicate a decline only after the

5. See National Income Committee, Government of India, Final Report (1954).
6. See Papers of the Conference of Research in National Income (1957).

Second World War. K. Mukherji[7] worked out two series which also reveal roughly the same trend. Surendra J. Patel's[8] series starts declining before the Second World War, presumably because he leaves out the tertiary sector in building up his series.

It is quite possible that not all sections of the people benefited from this rise in the *per capita* income. Utilising such wages data as are available for the period from 1873 onwards M. Mukerji[9] has built up an estimate of real wage movements for both agricultural workers and skilled craftsmen. But no clear rising trend is established up to the year 1900 although in individual years real wages registered even 15–16 per cent increases over the base year 1873. Money wages for agricultural workers increased by about 33 per cent over this period, while for certain groups of skilled workers money wages rose during the same period by over 40 per cent. In the organised industrial sector Jurgen Kuczynski's[10] data show a 2½–3 fold rise in money wages during 1880-1930 and a decline thereafter until wages were raised once again by the conditions brought about by World War II. The yearly earnings of factory workers rose more than three-fold between 1939 and 1950, the most marked increases being recorded during 1941–44 and again between 1947 and 1949. The movement of real wages, however, was erratic. The industrial workers probably could not protect their real wages against the rise in prices that occurred in the early years of the present century. It is even more certain that they suffered severely during the First World War when money wages failed to keep pace with the swiftly rising prices. The Depression years saw a fall in money wages, but in most cases wages had become relatively sticky so that real wages of industrial workers probably rose during 1930–39. Once again the inflation associated with the Second World War depressed real wages below the 1939 level, and although increased wages and dearness allowances helped to defend the industrial workers' levels of living, perhaps even in 1950 the real wages of most categories of workers had not been restored to their pre-war levels.

For the period of our study prior to 1873 relatively little information about wages is available. It appears that when employment for wages initially began to be offered in 1840–50 by the Public Works Department, the Railway Companies and later by the mines and factories, the usual level of money wages for unskilled workers was about Rs. 10 per month. This was 2–2½ times higher than the then prevailing level of rural wages.

7. See Mukherji, K., *Levels of Economic Activity and Public Expenditure in India*, pp. 57–58.

8. Patel, S.J. in *Indian Economic Journal*, January 1958.

9. Mukerji, M., *op. cit.*, pp. 628–29.

10. See Kuczynski, J., in *Economic History of India, 1857–1956*, edited by V.B. Singh (1965).

But the benefit of higher money wages was soon eroded by the sharp rise in prices during the 1850–60 decade. One estimate puts the rise in prices over this period at 50 per cent.[11] Hence, in spite of some rise in money wages, the real wage level probably declined throughout the period 1850–60 and did not show any improvement until prices fell once again after 1867–68. Since money wages did not rise appreciably in all the remaining years of the nineteenth century, the workers' real wages must have fallen once again when prices began to rise after 1875.

The above account of real wage movements in India since the middle of the nineteenth century has accepted as a working basis certain index numbers of prices which were not developed specifically with cost-ot-living indices in view. They were prepared by utilising either domestic wholesale prices or export and import prices. The Government of India publication *Index Numbers of Indian Prices, 1861-1931* did not use any weights, but built up a simple average of the price movements of 39 articles on the basis of a collection of wholesale prices.

The available indices of price movements enable us to group the years 1861–1950 into the following eight periods according to whether the dominant trend in prices was rising or falling:

1861-1866: A period of rising prices when the American Civil War created conditions favourable for Indian exports. This led to large imports of money metals into India and brought about a remarkable expansion in silver currency. It was perhaps the first occasion in Indian economic history when external factors exercised a profound influence on the domestic structure of prices.

1866–1883: Generally prices were falling during this period, although there were upturns in 1876 and 1879 when famine conditions raised prices of foodgrains. Much of the fall in prices can be regarded as reflecting the falling prices of imports which were coming to acquire a more and more significant role in India's economic life. This was a period when world prices were falling owing to tremendous technical improvements in production coupled with a cessation in the expansion of currency. The 'gold rush' of the 1850s was coming to an end while the use of silver as currency was being abandoned by most countries.

1883-1893: Prices began to rise in India earlier than in the rest of the world owing largely to the fact that Indian currency consisted of depreciating silver. Although silver prices had begun to fall in terms of gold since 1873, rupee prices continued to fall until about 1883 when monetary factors became more important than the underlying real factors in determining the course of prices.

1893–1899: Falling prices during this period are attributable to cur-

11. Mukherji, K., article in V.B. Singh (ed.), *op. cit.*, p. 645.

rency contraction initiated under the policy of closing the Indian mints to the free coinage of silver. The decline in prices would, in principle, have been greater than what it was if a series of famines did not work in the opposite direction.

1900–1913: This was a period of rising prices. According to Mr. K.L. Datta, whom the Government of India appointed as a one-man Price Enquiry Committee in 1910, average prices in 1907–11 were about 40 per cent higher than what they were during 1894-98. Mr. Datta's enquiry covered the period 1890–1912. He found that all commodities, except a few, had risen in price throughout this period, but the rise in prices was more marked after 1905. In his Report Mr. Datta distinguished between two groups of factors responsible for this rise in prices. In the first group were factors peculiar to India: these included real shortages as well as monetary over-expansion. According to Mr. Datta, agricultural products, including foodgrains, were already in short supply because of the failure of cultivation to keep pace with the growth of population. There had also been considerable substitution in favour of non-food crops. Even where new agricultural areas had been opened up for cultivation, the efficiency of cultivation was relatively poor. Export demand for Indian foodgrains and raw materials was also on the increase, helped by the improvement in rail and oceanic communications. Money supply had gone up, banking facilities had increased and credit conditions were easier than before. All these factors, according to Mr. Datta, favoured a rise in prices.

Mr. Datta mentioned also a second group of factors operating in the outside world to raise prices in India. Throughout the world industrial activity was going up while the supply of raw materials was not expanding equally fast. There was also the huge unproductive expenditure on war preparations in Europe which created excessive demand for strategically important minerals and materials. On the monetary side, the gold mines were being worked more efficiently than in the past, while new types of credit instruments were being evolved to economise on the use of gold. As India was directly linked to the gold-using countries after her abandonment of the silver standard in 1893, price movements in those countries produced immediate repercussions on Indian prices. Mr. Datta collected data to show that prices in U.K., U.S.A and Australia were all rising during this period.

Critics of the Government of India, however, put the entire blame for the rise in prices on the prevailing monetary policy. They argued that the government was indulging in over-issue of currency which was now very easy and profitable, since the rupee had become a token coin. To this argument the official reply was that rupees were coined only in response to the demands of trade and no deliberate policy of inflation had ever been adopted.

1914–1920: This was the period of the First World War when the pre-

viously existing rising trend of prices was severely accentuated. Between 1914 and 1920 the index of wholesale prices in Calcutta rose by over 100 per cent, according to official figures. Prices of foodgrains had risen over 93 per cent during 1914–19 while prices of imported textiles rose nearly three-fold and price of home-made textiles by over 60 per cent. Prices of all imported goods rose sharply. Prices of exportables were kept in check to some extent by war-time controls on exports and the lack of shipping facilities. Monetary expansion, an almost unavoidable accompaniment of war finance, must also have played some part in bringing about the sharp rise in prices.

1921–1939: This was a period when prices were generally showing a downward tendency from year to year. Although in 1935–36 there was a small recovery, this did not last long. The rapid fall in Indian prices from the peak of 1920–21 was arrested to some extent after the exchange stabilization of 1927, but once again prices started on their downward course in 1930 when the world-wide economic depression hit India. Between September 1929 and September 1931 the index of Calcutta wholesale prices fell from 143 to 91 (July 1914=100). During the depression years prices of raw materials fell much more rapidly than prices of manufactured goods. For instance, between September 1929 and March 1933 prices of Indian exportables fell by 51 per cent, but import prices fell by only 27 per cent. As a predominantly raw-material exporting country India suffered a serious deterioration in her terms of trade.

1940–50: With the coming of the Second World War (September 1939) prices once again showed a rising tendency. Within the first three months of the declaration of war, speculative forces drove wholesale prices up by 37 per cent. This upward thrust was reversed in the first eight months of 1940. Early British reverses in the war caused a flutter among speculators and prices fell. After August 1940 prices moved up once again. But no appreciable rise in prices occurred until 1943. From that period prices continually rose until in 1947–48 the general index of wholesale prices stood at 308.2 with prices of August 1939 as base; the cost of living indices stood on the same base at 307 in Bombay, 336 in Ahmedabad, 360 in Calcutta and 462 in Kanpur.

The causes of this sharp rise in prices were fairly obvious. The Government of India financed war expenditure in the Eastern theatres of war on behalf of the British Government by enabling the Reserve Bank of India to issue additional rupee currency against sterling paid by the British Government in a 'blocked' account held by the Reserve Bank of India at the Bank of England. For the British Government this implied the deferment of its liabilities to the Indian Government. For India this implied the sale of goods on credit to the British Government throughout the period of the war. The total expenditure financed by this method amounted to Rs. 1,740

crores. The volume of notes in circulation went up from Rs. 182.36 crores in 1938–39 to Rs. 1,319.86 crores in June 1948. While the currency thus expanded more than seven-fold, agricultural production did not increase even two-fold and the industrial production index in 1948 stood at only 105.8 (base: 1939 100). Imports increased from Rs. 151.88 crores in 1938-39 to Rs. 398 09 crores in 1946 47, but the import price index also increased nearly 2½-fold during the same period, so that there was no significant increase in the volume of imports. Hence, no effective safeguard against a general inflation was available.

To control any inflationary rise in prices the Government of India asked the Provincial governments as early as September 1939 to fix maximum prices for selected articles so that their prices might not exceed pre-war price by more than 10 per cent. But in the absence of effective control over supplies the Provincial governments could not be expected to succeed in their task. Subsequently the Central government experimented with measures to control wholesale prices, but had to beat a retreat when supplies disappeared from the open market and were available only in a 'black' market. After 1943 it came to be recognised that for effective price control the Provincial governments must be armed with adequate powers over distribution of supplies. The administrative apparatus did not prove equal to the latter task, however, and inter-Provincial distribution problems could not be judiciously settled by the Centre. The dislocation of transport during the war also added to the troubles of the 'deficit' provinces. Prices thus continued to soar, any local shortage in a commodity being magnified by hoarding which could not be effectively curbed in spite of various emergency powers assumed by the authorities from time to time. After December 1947 a policy of progressive 'decontrol' was adopted on the advice of some political leaders who believed that corruption could be eliminated only by dismantling the complicated apparatus of price and other controls. This led to a fresh spurt in prices until the authorities were forced to re-impose control measures on several commodities in 1948.

The Government of India's failure to evolve an effective system of price and distribution controls stands in sharp contrast to the British and American (not to speak of German) experience during the critical years of the war. Between 1939 and 1947 the wholesale price index in Britain rose by only 89 per cent, while the cost of living index was held after a rise of only about 30 per cent. In the U.S.A. also the cost of living index rose only by about 58 per cent during 1939–47. Although war-time regulatory measures were gradually taken off in these countries after 1946 and prices rose rather more sharply in the immediate post-war period, increases in production soon enabled these countries to curb the rate of rise in prices.

In India, on the contrary, the post-war period was marked by political uncertainties and upheavals with their inhibiting effect on economic activities. Hence, prices progressively increased in the years immediately

following the Second World War The general index of wholesale prices which had advanced to 209.3 in November 1945[12] (August 1939=100) continued to rise at an even faster rate. In 1946 the index rose by 38.3 points, and from January 1947 to June 1948 by no less than 79 points. Lack of fiscal discipline and the policy of decontrol in the midst of continuing scarcities aggravated the situation.

After the devaluation of the Rupee in September 1949 the problem of containing the domestic inflation assumed still greater importance. But the tasks of balancing the budget and curbing the money supply were not easy in the face of mounting demand for expenditure on defence (called for by Indo-Pakistani conflicts), the rehabilitation of the victims of partition and the proliferating development schemes in the public sector. In October 1949 the general index of prices touched 393.3 but fell back in the next few months. By the early months of 1950 the index was rising again and in July 1950 it stood at 405.2. No wonder, then, that the new-born Republic of India, ushered in on January 26, 1950, started her course with the real incomes of many vulnerable groups of people depressed below the already low levels of the pre-1939 years. But hope was kept alive by the promise of economic plans which were expected to increase productivity all around, reduce poverty and mitigate the disparities in incomes and levels of living that had become sharper during the war and the immediate post-war years.

National Income, Prices and Real Wages Since 1951-52

A basic objective of every Five Year Plan, launched in India since 1951 has been to initiate action for the faster growth of national and per capita incomes. The target for annual growth of national income usually adopted has varied around 5 per cent. With the present rate of population growth around 2.4 per cent per annum, this should permit at least a 2.5 per cent annual increase in the *per capita* income. If national income had in fact expanded at the targeted rate, it would have taken only about 28 years to double the *per capita* income.

The Five Year Plans, however, have more often then not fallen short of targets. As a result, even after three decades of planned development *per capita* income in 1980–81 (computed at 1970-71 prices) was no more than 1½ times of the *per capita* income in 1950–51. The average rate of growth of national income during the period 1950–51 to 1980–81 was 3.6 per cent, made up of the following rates over successive Plan periods (see next page).

The growth rate of national income remained vitally linked with the growth rate of agricultural output during the entire period and poor agricultural harvests reversed the direction of growth of national income in

12. The official price index took account of controlled prices only. Black market prices had of course gone up much higher.

Period	*Rate of growth of national income (per cent per annum)*
First Plan (1951–56)	3.6
Second Plan (1956–61)	4.0
Third Plan (1961–66)	2.3
'Plan holiday' (1966–69)	4.0
Fourth Plan (1969–74)	3.4
Fifth Plan (1974–79)	5.2
1979–81 (provisional estimate)	1.2

1957–58, 1965–66, 1972–73 and 1979–80. In several other years as well, the rate of growth of agricultural output as such was negative, for example, 1959–60, 1962–63, 1966–67, 1968–69 and 1972–73. In spite of periodic setbacks, however, a positive upward trend was maintained and this trend was definitely stronger than what was witnessed during the century before 1950, as revealed by available indices.

During the whole of the period 1951–81 the trend in prices has been upward, except for brief spells of downward price movements during 1953–55, 1968–69 and 1975–76. Between 1955–56 and 1960–61 wholesale prices rose at an average rate of 6.2 per cent per year, In the next five years the prices rose at an average rate of 9 per cent. Between 1965–66 and 1969–70 the average rate of inflation slightly declined to 8 per cent. Up to 1973–74 this rate was more or less maintained. Between 1973–74 and 1978–79, the annual rate of price increase declined to nearly 6 per cent, despite the huge increase in the prices of mineral fuel by 87 per cent in five years. This is explained by the relatively low rate of increase in the prices of food and other primary products which enjoy a weightage of nearly 42 per cent in the index of wholesale prices.

On the basis of a comparison between the national income figures at current prices and at constant 1970–71 prices, the course of price movements in the country appears to be as follows. In 1955–56 prices were about 13 per cent lower than in 1950–51. During the next two five-year periods prices rose by 22 per cent and 43 per cent respectively. Over the 'plan holiday' period of 1967-69 prices rose by 26 per cent. In the course of the Fourth Five Year Plan there was a 58 per cent rise in prices and over the Fifth Plan period prices rose by nearly 34 per cent. On combining these results it would appear that at the end of the Fifth Plan the price level was about 4½ times as high as it was in 1950–51.

The long period of continuous rise in prices produced its effects on the distribution of incomes among social classes. Only those whose money earnings rose faster than the rise in prices could benefit from the inflation; others had to suffer to a greater or smaller extent, depending on their ability to bargain for a compensating increase in money earnings.

Workers in registered factories, being better organised than workers in

small industry or agriculture, were more successful in raising their money earnings. According to figures compiled by the Government of India's Labour Bureau, the average earnings of factory workers rose from Rs. 1,187 per year in 1955 to Rs. 2,623 per year in 1969 and further to Rs. 5,614 per year by 1977. The compilation, however, was not based on identical coverage and hence the figures cannot be compared straightaway. Certain index numbers of workers' earnings in factories appear to indicate that in general money earnings in 1977–78 were not very much above twice the level obtaining in 1950–51, though certain specially privileged groups of workers had succeeded in securing a higher rise in earnings. On the whole one can say that the annual rate of increase in money earnings per worker has remained 3 to 4 percentage points below the rate of rise in prices. The real incomes of even this highly organised group of workers have thus been eroded by the inflation. However, if attention is confined to public sector employees only, per capita emoluments are found to have risen from Rs. 5,470 per year in 1970–71 to Rs. 14,239 in 1980–81.[13] The rate of increase of emoluments, accelerated after 1974–75, remained somewhat ahead of the rate of inflation.

A three-fold division of the Net National Product (at factor cost) into (*a*) compensation of employees, (*b*) mixed income of the self-employed, and (*c*) operating surplus will show that between 1970–71 and 1980–81 the payment of compensation to employees went up from 39 to 41 per cent, earnings of the self-employed declined from 46.7 to 45.4 per cent and what is described as operating surplus also declined from 14.3 to 13.6 per cent. This can be taken to indicate the emergence of a specially privileged group of high-salaried employees in various specialised occupations since, as already seen, money earnings of the general body of workers did not rise *pari passu* with the inflation. The decline in the share of mixed incomes of self-employed persons is indicative of an adverse effect of the inflation on farmers and small artisans. Thus, not only was the rate of growth of national income slower than was anticipated in the early days of development planning, but the distribution of income also became more lop-sided, the inflation working to the disadvantage of the relatively weak and underprivileged sections of the population. Yet better planning and striving for closer realisation of plan targets offer the only known solutions to the problem of improving the lot of the people. Every Five-Year Plan in India represents a step in the direction of higher levels of living as well as a more equitable distribution of incomes, since recent development plans in India have held up redistribution as an objective which is of no less importance than growth.

13. Government of India, *Economic Survey*, 1985–86, p. 144.

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A History of the Five Year Plans in India

The idea that after Independence the State will have to guide India's economy according to well-defined objectives and sound development strategies was in the air in India long before Independence. In the pre-Independence era, the private business sector was not conspicuous for its pioneering efforts, nor did it enjoy a high reputation for fair business practices. Hence recourse to laissez faire was ruled out from every point of view. The industrial leaders themselves were apt to look up to the State for various types of support for their schemes of expansion and were never dogmatically opposed to the intervention of the State in economic matters. In fact, in 1944 some of the top industrialists of the country joined together to publish a blue-print for future economic development in which the State was assigned a conspicuous role, not only in agriculture and basic infrastructure, but also in the industrial sector. This blue-print was called the Bombay Plan.

Earlier, in 1934, an engineer turned administrator in one of the Princely States, Sir M. Visweswaraya, had criticised the apathy of the British rulers of the country and pleaded for the preparation of plans for agricultural and industrial development. Visweswaraya was distressed by the ravages caused in India by the Great Depression o the 1930s and at the same time he was impressed by the well-formulated policies adopted by Britain and the other Western countries to save their people from the distress caused by the Depression. In his book, 'A Planned Economy for India', he did not attempt to construct any plan as such, but pointed to various ways in which the State had intervened in economic life in other countries to bring about economic recovery. At the same time when this way of thinking was being spread by Visweswaraya, reports were pouring in from Soviet Russia about the successful completion of their First Five Year Plan and the even greater success of their Second Plan. The Indian National Congress then decided to invite experts from various disciplines to help in formulating a plan for economic development, at least parts of which could be taken up for implementation by the Provinces which were being governed by the Congress Party after the nation-wide elections in 1937. This was the genesis of the National Planning Committee (NPC) (1938), set up by the then President of the Congress Party, Subhas Chandra Bose.

Jawaharlal Nehru served as Chairman of this Committee. A large number of sub-committees were formed to deal with specific aspects of development, but since their members were all otherwise busy, they were not regularly available for the deliberations. Within a few years interruption in the work of the sub-committees came in the form of the country-wide political movement of 1940–42. Quite a few prominent members, including the Chairman himself, soon found themselves behind prison bars. However, despite interruptions and shortage of funds, the NPC succeeded in assembling useful information and evolving important principles to guide development in future.

The Government of India itself, despite its adherence to liberal orthodoxy in the matter of involvement in economic affairs, found itself infected by the contemporary enthusiasm for economic planning. In the name of Reconstruction Planning a number of working groups and panels were set up between 1943 and 1945 which were asked to make forecasts about post-war imbalances between the demand and supply of various essential commodities and to suggest measures for dealing with such imbalances. A new Department, called the Planning and Development Department was created in August 1944 to deal with matters relating to post-war reconstruction and development.

Shortly before Independence an Interim government was formed at the Centre with some prominent Indian political leaders as Members of the Governor General's Executive Council. In October, 1946 the Interim government set up an Advisory Planning Board (Chairman: K.C. Neogy) to make an intensive study of the various reconstruction schemes and panel reports already drawn up in different government departments and to make recommendations about the best way of putting these into use for economic development in India. The Advisory Planning Board in their Report (January 1947) recommended that a full-time Planning Commission should be set up under the Central government with the following functions:

(*a*) Scrutiny and co-ordination of the Provincial Plans and Plans of Central Departments;

(*b*) Making recommendations to Government as regards the allocation of Central funds for development purposes;

(*c*) Formulating plans for the development of major industries and important minerals;

(*d*) Making recommendations to Government regarding various forms of State aid and State control to be extended to industries;

(*e*) Making recommendations to Government regarding trade both foreign and internal;

(*f*) Making recommendations regarding monetary and financial policy, including currency and credit at home and abroad, as affecting the planned development of the country;

(*g*) Watching and stimulating progress in regard to the executive of the plans referred to in (*a*) and (*c*) above, compiling and publishing statistics relating to them, suggesting adjustments and modifications in them and initiating new plans;

(*h*) Allocating material resources which are in short supply so as to ensure that due regard is paid to principles;

(*i*) Examining the implications of scientific research and discovery on economic welfare.[1]

On the basis of this set of recommendations the Government of India brought the Planning Commission into existence on March 15, 1950. The Commission was set up by an Executive order and does not enjoy statutory authority. Initially the Commission was constituted with 6 members and a Chairman. The Prime Minister himself assumed the position of Chairman of the Commission. None of the other members were associated with the administration either as Ministers or as officials.

In setting up the Planning Commission the Government of India was guided primarily by the Fundamental Rights guaranteed by, and the Directive Principles of State Policy embodied in. the Indian Constitution which enjoin upon the government to secure (*a*) that all citizens can have an adequate means of livelihood (*b*) that the ownership and control of the community's resources are so distributed as to best subserve the common good, and (*c*) that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment. As an agency for securing these basic objectives, the Planning Commission was instructed:

(*a*) to make an assessment of the country's material, capital and human resources and investigate possibilities of augmenting the supply of deficient resources;

(*b*) to formulate a plan for the most effective and balanced utilisation of the country's resources;

(*c*) to determine priorities and define the stages for the plan and allocate resources accordingly;

(*d*) to indicate factors retarding progress of the plan and spell out the conditions for its successful implementation;

(*e*) to indicate the nature of the machinery that will be needed at each stage for successfully implementing the plan;

(*f*) to appraise periodically the progress of the plan and recommend necessary adjustment measures;

(*g*) to recommend measures needed for the discharge for the duties assigned to it or for improving upon current policies and programmes as well as to advise the Central and State governments regarding specific problems referred to it.

1. Report of Advisory Planning Board, Para. 82.

A draft outline of the First Five Year Plan, covering the period April 1951–March 1956 was drawn up by the Commission in July 1951. It dealt with some projects that were already under execution as well as other projects that were to be taken up if adequate funds, mainly in the form of foreign exchange, were made available. The total outlay envisaged was Rs. 1793 crores in five years. The Planning Commission intended that the draft outline should form the basis for wide public discussion. The plan was to be finalised after several rounds of discussion with executive agencies at the Centre and in the States as well as after ascertaining the views of Members of Parliament and State legislatures.

In its final form, as presented in December 1952, the First Plan envisaged a total outlay of Rs. 2068.78 crores. All the programmes included in the 1951 draft were retained and some new programmes were added, particularly in respect of industrial development. The major emphasis, however, was on schemes of agricultural and irrigation development, power generation, and the rehabilitation of the railway system. For agriculture, irrigation and power the Plan proposed an outlay of Rs. 922 crores which was 44 per cent of the total outlay. For the railways an outlay of Rs. 250 crores was proposed. Industrial and mineral development received less importance; the allotted outlay was only Rs. 168 crores. In social services, education was allotted Rs. 156 crores and health Rs. 99.5 crores. Expenditure on rehabilitation of persons displaced after the partition of the country was also included in Plan outlay, the amount being Rs. 85 crores. Of the total outlay, the Central government was to be responsible for about 60 per cent (Rs. 1240.5 crores) and the States and Union territories for the rest.

In a Mixed Economy the responsibility for planned development has to be shared between the public agencies and private enterprise in an agreed manner. The anticipated investment for industrial expansion in the private sector during 1951–56 was stated to be Rs. 233.30 crores. In addition, schemes of modernisation in certain established industries, costing about Rs. 150 crores, were also expected to be undertaken during this period.

The national income of India, estimated as approximately Rs. 9000 crores in 1950–51, was expected to go up to about Rs. 10,000 crores by 1955–56, provided that capital formation rose by about 20 per cent of additional income each year. This calculation was based on an assumed investment-income ratio of 3 : 1 and a lag of 2 years between the date of investment and the emergence of additional income. The Planning Commission also made calculations for a longer period. They showed that if from 1956–57 onwards 50 per cent of additional income were used for stepping up investment, then per capita income could be doubled in 27 years and per capita consumption could be raised by about 70 per cent above the 1950–51 level. In working out these long-run estimates, the

Commission assumed that population growth would be at a constant rate of 1.25 per cent per annum.

Regarding the creation of employment opportunities through planned development, the Planning Commission, aware of the heavy capital cost of creating jobs in large-scale industry, suggested that small and cottage industries should be encouraged to develop and their technology should be so improved that they can ensure a reasonable level of income to their workers. Adoption of labour-intensive processes to the maximum extent possible was the only way in which the twin objectives of higher production and greater employment could both be realised. The First Plan proposed an outlay of Rs. 27.04 crores on cottage and small industries, mainly with an eye to strengthening the organisation supporting such industries and improving training facilities for artisans and workers. Reservation of certain spheres of production for small and cottage industries and imposition of a cess on large units for the benefit of smaller enterprises also received the support of the Planning Commission.

The First Plan's proposed outlay of Rs. 2069 crores was to be financed by (*a*) savings in the government sector in the form of revenue surplus (Rs. 738 crores), (*b*) loans and deposits from the public (Rs. 520 crores), (*c*) external assistance (Rs. 520 crores), and (*d*) deficit financing (Rs. 290 crores). Any adverse impact of deficit financing on prices was proposed to be counteracted by a system of efficient controls over the distribution of essential commodities.

For the full implementation of the First Plan, a balance of payments deficit of Rs. 180–200 crores per annum might be necessary. While part of this deficit would be met from the sterling reserves built up during the war,[2] the rest of the deficit could be met only if external assistance were stepped up to the required extent.

The aggregate investment, public and private, over the period of the First Plan was to be Rs. 3500–3600 crores, about half of which was to be in public sector projects. It was estimated that this level of investment could be reached by raising the rate of domestic saving from about 5 per cent of national income in 1950–51 to 6.75 per cent in 1955–56 as well as by drawing upon available external resources.

The First Plan did not attempt any careful checking of the internal consistency of the various projects which were taken up for implementation. Many of these projects had been formulated before the Planning Commission was set up and some progress had already been achieved in their implementation. The Planning Commission could not examine at this stage the inter-relationships among the different projects. Only a simple macro-model of the Harrod-Domar type was used to assess the likely impact of

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2. The release of sterling payments to India, blocked by Britain during the war, was about Rs. 50 crores per year.

additional investment on income. The emphasis was on raising the level of investment to the maximum extent possible, without unduly depressing consumption, and to strive for lowering the incremental capital-output ratio as much as practicable by adopting relatively labour-intensive techniques of production. However, a few capital-intensive projects had also been included in the Plan for multi-purpose irrigation and power development, expansion of steel-producing capacity, rehabilitation of the railway system and the like.

The Second Five Year Plan (1956–61) was based on a strategy of development planning which is associated with the name of Prof. P.C. Mahalanobis and has a close resemblance with the Feld'man model of planning which is supposed to underlie the early Five Year Plans of Soviet Russia. The Mahalanobis strategy consists in giving priority to machine-building ('heavy') industries in the allocation of investment funds. The development of 'light' industries turning out consumer goods or simple machines is given less importance. This strategy is calculated to accelerate the rate of growth of the economy in the long run, although the growth rate may not be very high in the immediate short run. As the country attains self-sufficiency in the production of heavy machinery, it can reduce its dependence on foreign nations for machinery imports. This facilitates subsequent development. But the acceleration of the growth rate was not Prof. Mahalanobis's only concern. He was at the same time in favour of the development of small and cottage industries which could create employment for relatively less skilled workers without making much demand on investment funds. The Second Five Year Plan had thus a two-pronged strategy, combining heavy industry development with the fuller utilisation of manpower in small and cottage industries of the traditional type.

The Second Plan was designed to lay greater stress on industrial and mineral development, as compared with the First Plan which emphasised agriculture, irrigation and power-generating capacity.[3] From about 8 per

3. The following table shows the variations between the First and Second Plans regarding emphasis on different types of projects.

	First Plan as formulated in 1952	*First Plan as revised in 1953*	*First Plan actual outlay*	*Second Plan as formulated in 1956*
Agriculture, Irrigation and Power	921.8	1001.8	872.8	1481.0
Industry & Minerals (including Scientific Research)	173.0	188.2	96.8	890.0
Social Services	339.8	395.9	316.2	945.0
Rehabilitation	85.0	135.7	95.7	
Miscellaneous	52.1	86.0	60.7	99.0
	2068.8	2377.7	1960.0	4800.0

cent in the revised First Plan, the allocation for industrial and mineral development was raised to about 18.5 per cent in the Second Plan. Correspondingly, the allocation for agriculture, irrigation and power development was reduced from 42 per cent to 31 per cent. However, in the actual implementation of the First Plan, an almost 20 per cent short-fall had occurred, the actual outlay over 1951-56 being Rs. 1960 crores against the revised plan target of Rs. 2378 crores. Industrial development plans accounted for only 5 per cent of actual outlay, against the 8 per cent initially provided for. The relative share of agriculture, irrigation and power rose to 45 per cent of public sector Plan outlay, as against 42 per cent originally assigned to this sector, although in absolute figures there was a short-fall of about Rs. 120 crores in these programmes as well. Programmes relating to railways and road development, however, were implemented practically to the fullest extent.

The Second Plan was up against formidable difficulties almost from the beginning. The Plan outlay had been raised from Rs. 1960 crores to Rs. 4800 crores, but the vital financial resources were not within sight. A gap of Rs. 400 crores remained in the scheme of financing associated with the Plan, even after allowing for Rs. 800 crores of external assistance and Rs. 1200 crores of deficit financing.[4] Accordingly, the Second Plan had to be revised two years later. It was split into two parts—the first part consisting of the more essential projects and accounting for a sum of Rs. 4500 crores, and the second part consisting of less essential projects to be implemented only if additional financial resources became available. In the event, the actual outlay on the Plan over 1956-61 amounted to Rs. 4672 crores. The essential projects in the fields of industrial and mineral development were safe-guarded, largely by curtailing programmes in respect of the social services. The Plan was financed by vigorous measures of additional domestic taxation. In spite of this effort, more than one-fifth (22.5 per cent) of the total Plan outlay had to be met by drawing on foreign assistance. The extent of deficit financing (Rs. 954 crores) was, however, smaller than the amount initially envisaged when the Plan was drawn up.

4. Comparative schemes of financing the First and Second Plans were as shown below:

	First Plan (*Actual*)	*Second Plan* (*Provisions*)
Surplus from Govt. revenues	752	950
Public borrowing and deposits	686	1450
External assistance	189	800
Deficit financing	333	1200
	1960	4400
	Uncovered gap	400
		4800

The Second Plan aimed at raising the level of national income from Rs. 10,800 crores in 1955–56 to Rs. 13,480 crores in 1960–61 (both figures expressed in 1952–53 prices). As national income increased, the level of domestic saving would naturally go up and, with some measure of foreign assistance, domestic investment could rise faster. It was expected that the ratio of investment to national income could be raised from 7.3 per cent at the end of the First Plan to 10.7 per cent at the end of the Second. However, the hope expressed in the First Plan that the marginal rate of domestic saving could be raised to 50 per cent from 1956-57 onwards was now described as "excessively high". The First Plan had expected to attain a 20 per cent rate of investment by 1968–69; in the Second Plan the highest attainable rate was scaled down to 16–17 per cent, to be reached during the Fifth Five Year Plan. At the same time as Plan priorities shifted towards 'heavy' industrial projects, the incremental capital-output ratio was sure to go up. Accordingly the rate of growth of *per capita* income was also expected to be slower than what the First Plan had initially regarded as achievable.

Private Sector investment during 1956–61 was estimated at Rs. 3100 crores, as compared with Rs. 1800 crores over the period of the First Plan. The yearly level of investment, measured as Rs. 500 crores in 1950–51, rose to Rs. 850 crores by 1955–56 and about Rs. 1600 crores by 1960–61. These figures, however, were reckoned at current prices. By 1960-61 the wholesale price index was nearly 30 per cent above the level in 1955–56, but between the opening and closing years of the First Plan there had been a fall of about 18.5 per cent in wholesale prices.

The Second Plan registered a growth of 19.5 per cent in five years, although the Planning Commission had planned for a 24.5 per cent growth. In the First Plan, the targeted growth of national income was 12 per cent, but the actual growth was 18.5 per cent. The over-all capital-output ratio in the First Plan turned out to be 1.86: 1 against the assumed ratio of 3 : 1. The index of agricultural production went up by nearly 22 per cent between 1950–51 and 1955–56, but in the following five years the growth was only 15.4 per cent. By contrast, the index of industrial production, which rose by 39 per cent during 1951–56 advanced further by 39.6 per cent during 1956-61.

The work on the Third Five Year Plan started towards the end of 1958, leading to the publication of the Draft Outline in July 1960. After consideration in the National Development Council in May 1961, the final version of the Plan was released. The aim of this Plan was "to give a more precise content to the social objectives of the Constitution" and to make further advance towards the realisation of those objectives. During the period of the Second Plan, agricultural development had been relatively tardy and critical shortages had developed in respect of foodgrains and several raw materials for industry. Imports of food, raw materials and

industrial machinery were increasing much faster than the growth in exports. The trade deficit rose from Rs. 588 crores during 1951–56 to Rs. 1836 crores during 1956–61. In the Third Plan, therefore, it was necessary to plan for self-sufficiency in foodgrains and larger agricultural production. It was necessary at the same time to attain greater self-sufficiency in the machine building industries "so that the requirements of further industrialisation can be met within a period of ten years or so from the country's own resources". The Planning Commission also expressed their concern over the growing inequality of incomes and economic power in the country and promised to bring about, through the Third Plan, "reduction in disparity in income and wealth and a more even distribution of economic power."

With an eye on these objectives, as well as to secure the fullest possible utilisation of the country's manpower resources, the Planning Commission framed the Third Plan with a targeted growth of 30 per cent in agricultural production, 32 per cent in foodgrains production and as much as 70 per cent in industrial production over the five year period 1961–66. In other words, agricultural production was expected to increase at 5.4 per cent, foodgrains production at 5.7 per cent and industrial production at 11.2 per cent per annum. To achieve such unprecedented rates of growth, the Third Plan proposed a 70 per cent increase in public sector investment over the total of the previous five years and a 32 per cent increase in private sector investment. From about Rs. 1600 crores per year in 1960–61 aggregate public and private sector investment was to be raised to about Rs. 2600 crores in the final year of the Third Plan. This implied a rise in the ratio of net investment to income from 11.5 per cent to 14 per cent. It was hoped that the ratio of domestic saving to income could be raised over the years 1961-66 from 8.5 per cent to 11.5 per cent and at least to this extent the dependence on foreign resources for investment could be reduced.

The public sector outlay for the Third Plan was settled at Rs. 7500 crores of which the investment component was to be Rs. 6300 crores and current development outlay was to account for the remaining Rs. 1200 crores. The distribution of public sector outlay in the Third Plan followed a pattern in which agriculture, irrigation and power projects would account for 36.4 per cent of the total plan outlay, industrial and mineral development for 23.8 per cent, transport and communication for 19.8 per cent and the remaining 20 per cent would be spent for social services, inventory accumulation and miscellaneous purposes. Thus, the relative importance of agricultural schemes and power development was substantially increased in the Third Plan by cutting down allotments (in a relative sense) for transport and the social services.

The Third Plan was in a sense bigger in size than indicated above, since all the schemes that had been worked out for inclusion in this Plan would have involved an outlay of Rs. 8098.53 crores in the public sector. However,

due to paucity of financial resources the Planning Commission had to recommend that the outlay should remain limited to Rs. 7,500 crores. The anticipated amount of private sector investment over the period 1961-66 was Rs. 4100 crores. Taken together with the investment component of Rs. 6300 crores in the Plan outlay, the aggregate investment over the Third Plan period would be Rs. 10,400 crores. This was expected to lead to a rise in national income from Rs. 14,500 crores at the end of the Second Plan to Rs. 19,000 crores in the final year of the Third Plan, representing a growth of 31 per cent in five years. The annual rate of growth was to be almost 5.5 per cent. Allowing for the rate of population increase, this could yield *per capita* income growth at 3.2 per cent per year. A doubling of *per capita* income in a little over 20 years' time thus emerged as a distinct possibility.

In order to finance the public sector Plan outlay of Rs. 7,500 crores, the Planning Commission suggested drawing upon the government's current surplus (including surplus of public enterprises) to the extent of Rs. 2800 crores, on public loans and deposits amounting to Rs. 1950 crores, on external assistance up to Rs. 2200 crores and depending on deficit financing for the remaining Rs. 550 crores. It was regarded as both possible and judicious to depend for nearly 30 per cent of the Plan outlay on external sources. The domestic tax-payers were to be subjected to additional taxes and other imposts amounting to over Rs. 1700 crores. The proportion of tax revenue to national income, which had gone up from 7.5 per cent to 8.9 per cent during the Second Plan, was expected to move up further to 11.4 per cent in the course of the Third Plan.

The decennial census of 1961 revealed that between 1951 and 1961 the population of the Indian Union had gone up by 7.7 crores. This implied that the number of people of working age was going up by 30-35 lakhs per year. The various projects included in the Second Plan were expected to increase employment opportunities for 80 lakh people. Nearly 90 lakh people were reckoned to be without any opportunities for employment when the Second Plan ended. The Third Plan held out the prospect that over the years 1961-66 another 1 crore 70 lakh people would reach their working age, whereas the projects included in the Plan could create employment opportunities for at most 1 crore 40 lakh people. Thus the backlog of unemployment would increase by another 30 lakhs. To deal with the growing unemployment problem, the Planning Commission proposed massive programmes of rural public works. However, the allocation proposed for such programmes being only Rs. 150 crores, only about 100 days of employment in a year could be thus provided and that also to a limited section of the unemployed population.

Like the two previous Plans, the Third Plan also was set in the perspective of a longer-term plan covering the fifteen years from 1960-61 to 1975-76. This 'perspective plan' aimed at raising the national income from Rs. 14,500 crores in 1960-61 to Rs. 34,000 crores in 1975-76, both at

1960–61 prices. The corresponding increase in per capita income would be from Rs. 330 to Rs. 530. Employment opportunities would be created outside agriculture for more than 4.6 crore persons. The proportion of population dependent on agriculture was expected to decline from about 70 per cent to 60 per cent. By 1975–76 the ratio of investment to national income was expected to be between 19 and 20 per cent and the ratio of domestic saving to national income would go up from about 8.5 per cent in 1960–61 to 18 or 19 per cent. Reduction of dependence on foreign resources for the purpose of investment was an objective to be pursued throughout this period.

The Third Plan period was marked by a series of unforeseen calamities. The first of these came in the form of a border conflict between China and India in October 1962. The defence outlay in the 1962–63 budget of the Central government had to be increased by Rs. 95 crores. Several types of defence bonds had to be issued to raise additional funds. In the light of defence requirements, the Plan priorities had to be re-cast to some extent. Taxation had to be increased substantially in the 1963–64 budget to pay for the increased expenses of both defence and development. However, the annual outlays on the Plan did not have to be curtailed and were increased every year by 15–20 per cent.

The requirements of defence loomed large once again when India became involved in a war with Pakistan in September 1965. The working of the Plan, however, was not allowed to be affected by this, though fresh resources had to be raised. The revenue receipts of the Government of India increased from Rs. 406 crores to Rs. 877 crores in the ten years covering the first two plans, but over the years of the Third Plan these receipts reached the level of Rs. 2320 crores. Capital receipts of the Central government, however, increased at a slower pace during the Third Plan than during the Second. In the States also both revenue and capital receipts went up by 83 per cent and 126 per cent respectively over the Third Plan years. Additional taxation amounting to Rs. 2883 crores was necessary to meet the twin requirements of development and defence, the Centre's share in additional taxation being Rs. 2,273 crores.

In the final year of the Third Plan (1965–66) the country was hit by severe drought conditions which recurred in 1966–67 as well. The agricultural programmes in the Third Plan were totally upset by this adverse turn in weather conditions. The general index of agricultural production (base 1949-50=100), which had gone up by 42.2 per cent in the course of the first two Plans, dropped to the extent of 6.7 per cent in 1965–66 as compared with 1960-61. The foodgrains production index dropped even more markedly by 11.8 per cent. There was a fairly sharp decline in the production of all principal cereal crops, pulses, cotton and most oilseeds. Industrial production, however, was not yet adversely affected by the failure on the agricultural front. By the final year of the Third Plan the general index

of industrial production was about 47 per cent above the index for 1960–61. The annual rate of expansion of industrial output in the Third Plan was a little higher than that in the Second Plan (8 per cent as against 7.2 per cent).

The national income at 1960–61 prices went up from Rs. 13,290 crores in the final year of the Second Plan to Rs. 15,920 crores in 1964–65, but declined to Rs. 15,020 crores in 1965–66. The counter-part of the 6.7 per cent decline in agricultural productions in 1965–66 was a 5.7 per cent decline in national income. It may be noted that, even before the agricultural disaster struck the country in the final year of the Third Plan, the average rate of national income growth was about 4.6 per cent which was below the rate envisaged in the Plan. One reason why, despite substantial increases in Plan outlay at current prices, the outcome was relatively unsatisfactory lay in the continuous and accelerating rise in the price level. The average inflation rate over the period 1962–66 (March to March) was nearly 8.5 per cent.

In terms of financial outlay the Third Plan turned out to be about 14 per cent bigger than was initially intended; a planned outlay of Rs. 7500 crores grew into an actual outlay of Rs. 8577 crores. In the process the Plan priorities changed in favour of transport and communications, while social services suffered most from the revised allocations. Dependence of Plan investment on external assistance was, however, marginally lower than was initially envisaged. This was compensated by a marked step-up in additional tax collections and by running into deficits. There was a short-fall in respect of targets of public borrowing and a scheme of compulsory deposits was introduced.

The total import bill during the Third Plan period turned out to be about Rs. 1400 crores more than during the Second Plan period, while export earnings increased by only Rs. 760 crores. The deficit in the current balance of payments, however, was smaller than the trade deficit, mainly because a flow of official transfer payments in favour of India was consistently maintained. In 1965–66, however, this flow was cut down to almost half its size in the previous year. The inflow of official capital funds also declined by about Rs. 50 crores in the final year of the Third Plan. With the outbreak of hostilities between India and Pakistan in the autumn of 1965 the outlook for foreign assistance for the Plans became uncertain to some extent. It was argued that the existing policies of export promotion, based on various forms of export subsidies, were unsuitable as methods of improving the trade balance. A devaluation of the Rupee in relation to the U.S. dollar and other important world currencies was advocated as the most effective solution of the balance of trade problem. Accordingly, on June 6, 1966 the Rupee was officially devalued.

The Fourth Plan, of which a draft outline had been prepared and published in 1966, became clouded by uncertainties in the wake of the devalua-

tion. The outlook for foreign assistance also appeared as none too promising. As a result the important decision was taken to guide the economy on the basis of short-term Annual Plans instead of engaging immediately to finalise the next Five Year Plan. The draft outline of the Fourth Plan (1966–71) suggested a total outlay of Rs. 16,000 crores of which Rs. 13,600 crores would be in the form of public investment. Private investment was anticipated at Rs. 7,750 crores. The national income target for 1970-71 was taken as Rs. 29,500 crores (at 1965–66 prices), which implied a 38 per cent increase over the 1964–65 level of national income and a 48 per cent increase over the depressed national income level of 1965–66. The *per capita* income was expected to increase at an annual rate of 3 per cent.

In 1966–67 there was a small recovery in agricultural production, as compared with the previous year, but the drought conditions persisted and food production still remained 1.3 crore tonnes below the 1964–65 peak of 8.9 crore tonnes. On the industrial front, the situation was worse than in the previous year. The inflation rate rose to nearly 16 per cent. In 1967–68 agricultural production registered a fairly sharp increase, but the industrial recession was not lifted. The next year, 1968–69, witnessed a reversal in agricultural expansion and only a slow progress in industry. For the period 1966-69 the average growth rate of national income (at 1960–61 prices) was about 4 per cent, but this is explained by the sharp increase of over 9.6 per cent during 1967–68 which was almost exclusively attributable to an agricultural recovery.

As normalcy was restored by 1969, a reconstituted Planning Commission was entrusted with the work of drawing up a new medium-term Plan for the next five years. After considering the changes that had occurred in the economic environment during 1966–69, the Planning Commission came out with the final version of the Fourth Plan (1969–74). It received the approval of the National Development Council in May, 1970.

Between April 1966 and March 1969 the total outlay under various Plan schemes amounted to Rs. 6756 crores. The major shift in Plan priorities during this 'Plan Holiday' period occurred in favour of power projects and the organised industrial sector, while irrigation, rural industries and social services came to be accorded relatively less importance than before. As foreign currency assistance was of greater value in terms of rupees after the 1966 devaluation, it is not very surprising that nearly 36 per cent of the Plan outlay during 1966–69 was met out of external assistance. Though additional taxation was also resorted to, its scope was limited because of the generally depressed economic conditions. Deficit financing was restricted to only about 10 per cent of the Plan outlay. Public loans and deposits yielded relatively more for the financing of the Annual Plans during 1966–69, compared with the yield from these sources during the Third Plan years.

In 1968–69 the general index of agricultural production was only 11 per cent above the 1960–61 level. There had been a remarkable increase in wheat production and some increase in rice production, but the production of pulses, groundnut and jute was still below what had been achieved by 1960–61. Some industries like jute and cotton textiles, leather products, railway wagons and electrical machinery were considerably depressed. Others were generally producing below capacity. Prices, however, remained fairly steady and the trade deficit became narrower. The volume index of exports (base 1958=100) rose from 119 in 1966–67 to 142 in 1968–69, but the unit value index declined to some extent. Import prices, however, declined more sharply, while the volume of imports registered only a mild increase. The industrial recession was largely responsible for both the spurt in exports and the negligible rise in the volume of imports.

In the Fourth Plan for 1969–74 the proposed public sector outlay was Rs. 15,902 crores, made up of Rs. 13,655 crores of investment and Rs. 2247 crores of current development outlay. As much as 39.3 per cent of this outlay was directed towards agriculture, irrigation and power development, industries and minerals accounted for 22.8 per cent, transport and communications for 20.3 per cent and social services and miscellaneous programmes for the remaining 17.6 per cent. The greater emphasis on agricultural programmes in this Plan was the outcome of adopting 'self-reliance' as an important objective of planning; in particular, the aim was to enable the country to do away with food loans under U.S. Public Law 480 on which the country had become increasingly dependent following the severe droughts in the mid-60s. The private sector investment over the Fourth Plan years was anticipated at Rs. 8980 crores. It was expected that, with these amounts of public and private investment, the economy would attain a 5.5 per cent average rate of growth in the next five years. In terms of 1960–61 prices. The national income was to increase from Rs. 17,351 crores to Rs. 22,862 crores.

Growth, however, was not the only objective. What was needed was the association of growth with stability. Hence the stress was on non-inflationary methods of financing the Plan. Moreover, the Fourth Plan stressed the urgency of reducing the concentration of economic power by planning for "a wide dispersal of entrepreneurship". To provide greater employment opportunities in rural areas, a number of labour-intensive rural works schemes were incorporated in the Plan. Finally, to carry the benefits of planned development to the remotest rural areas a specially worked-out programme of minimum needs (rural roads, water supply, education, power supply etc.) was made an integral part of the Plan.

The aim of self-reliance was more than achieved in the Fourth Plan, since only about 13 per cent of the actual outlay of Rs. 15,783 crores was met out of external assistance. But additional taxation as well as the

extent of deficit financing had to be stepped up, beyond the levels decided upon at the stage of Plan formulation.

So far as its impact on production was concerned the Fourth Plan was extremely disappointing. The index of agricultural output rose by less than 9 per cent between 1969–70 and 1973–74. In cereals the production gain was of the order of 8.6 per cent. But pulses registered a 14.7 per cent decline. The index of industrial production rose by only 14.3 per cent between 1970 and 1974. Production declined in non-ferrous basic metals, electrical equipments, rayon and other synthetic fibres and paper mill products. There was near-stagnation in iron and steel, cement, cotton spinning and weaving and heavy organic chemicals. High rates of growth were, however, recorded in fertilizer production, agricultural machinery (specially tractors) and engineering goods. The national income attained a level of Rs. 20,179 crores, nearly Rs. 2700 crores short of the originally set target; the annual growth rate was just above 3 per cent.

The price level, after remaining fairly steady during the first three years of the Fourth Plan rose rather more sharply in the last two years. The average inflation rate for the whole period of the Plan was nearly 11 per cent per annum. In the last two years alone the prices of foodgrains rose by over 36 per cent. The last year also saw a sharp rise in the prices of petroleum and products like kerosene, because of the rise in world oil prices. The Indo-Pakistan war of 1971, leading to the creation of Bangladesh as a separate State, was partly responsible for the acceleration in inflation.

The index of the volume of exports was 25 per cent higher in the final year of the Plan as compared with 1969–70. Imports also rose above the abnormally depressed levels of 1968–70, but due to some improvement in export prices relative to import prices, the trade deficit was only about Rs. 780 crores in five years. The impact of the higher prices of imported petroleum products on the trade balance was not severely felt until 1974–75. Foreign exchange reserves rose by nearly Rs. 34 crores between 1969–70 and 1973–74. But this was accompanied by a rise in the external debt of the Government of India by about Rs. 232 crores.

The work of drawing up the Fifth Five Year Plan (1974–79) was taken up during 1971–72 by a re-constituted Planning Commission. This Plan was based on a model in which the growth objective was sought to be integrally related to the re-distribution objective. The earlier Plans had done very little to improve the purchasing capacity of the very poorest sections of the population. The thrust of the Fifth Plan was on increasing the level of consumer expenditure for the bottom 30 per cent of the population by reducing the expenditure levels of the top-most sections. Since the poor consume less of import-intensive goods, the redistribution of purchasing power in favour of the poor was expected to be helpful from the point of view of the foreign trade balance as well. To add to the income-earning capacity of the poorest sections, it was proposed to take up special

employment-generating schemes which were also to result in the creation of valuable social assets.

The final version of the Fifth Plan was designed for only a 4.4 per cent rate of national income growth. The priorities shifted in this Plan towards rural development, though the allocation for village and small industries was reduced in comparison with the Fourth Plan. The primary emphasis was on minor irrigation and other agriculture-related schemes which were expected to help in generating additional employment in rural areas. The public sector Plan outlay over 1974-79 was to be Rs. 39,322 crores at 1972-73 prices of which the investment component was Rs. 37,250 crores. The aggregate private investment during this period was expected to be Rs. 27,049 crores.

The estimates on which the Fifth Plan was based got upset due to the subsequent price increases. In the very first year of the Fifth Plan wholesale prices rose by over 25 per cent, the sharpest rise occurring in the prices of minerals and liquid fuel. Agricultural production increased by about 10 per cent and industrial production by 20 per cent or so by 1977-78. The Fifth Plan was terminated one year ahead of schedule when a coalition government was formed by non-Congress opposition parties at the Centre and this Janata government decided to work on a new Plan for 1978-83.

During 1974-78 the net national product increased in real terms at an average rate of 4.5 per cent. The net domestic saving ratio went up from 13.2 per cent in 1973-74 to 17 per cent in 1977-78 which was higher than the prevailing rate of capital formation (15.3 per cent).

Mainly because of a nearly four-fold increase in the expenditure on imported petroleum and petroleum products, the balance of trade situation in 1977-78 was worse than in 1973-74. But the oil crisis had a brighter side as well. With the increase in employment opportunities in the oil-producing Middle-Eastern countries, there was a substantial out-migration of Indian workers to these countries. Remittances received from such workers provided much-needed relief to India's balance of payments. There was also an appreciable increase in external assistance in the closing years of the Fifth Plan. The foreign exchange reserves of the country rose from Rs. 580.78 crores at the end of the Fourth Plan to Rs. 4500 crores by the end of the Fifth Plan. As a proportion of the value of imports, foreign exchange reserves (excluding gold and SDRs) stood at 19.8 per cent in 1973-74 and nearly 75 per cent in 1977-78. Against this rise in foreign exchange reserves there was the expansion in Government of India's external liabilities from Rs. 5824 crores to Rs. 8985 crores.

Prices rose by over 25 per cent in one year as the world-wide 'Oil Crisis' hit India in 1974-75. This was also a year of poor agricultural production. In the remaining three years upto 1977-78 prices remained fairly steady. The Fifth Plan (inclusive of Plan outlay for 1978-79) succeeded in avoiding deficit financing to a large extent; a mere 3.4 per cent of the total outlay

of Rs. 39,426 crores[5] was met by having recourse to this mode of financing. Additional taxation and other revenue-raising measures adopted during this period financed over 37 per cent of the Plan outlay and nearly 30 per cent of outlay was financed by public borrowing and miscellaneous capital receipts. Less than 15 per cent of the financial resources for the Fifth Plan was obtained from external assistance. Price stability and self-reliance in financing Plan outlay were realised to a large extent in this Plan. But agriculture still faced problems caused by adverse weather conditions, while industrial output increased at an unimpressive rate (below 8 per cent per annum) except during the first year of the Emergency (1975–76).

The Draft Plan for 1978-83, drawn up in accordance with the policies approved by the coalition (Janata) government (1977–79) by a re-constituted Planning Commission, provided for a public sector outlay of Rs. 69,380 crores (at 1977-78 prices). The allocation for power development was markedly increased in this Draft Plan, since the shortage of power was hindering full utilisation of installed equipments in several industries. The reliance on external assistance for financing the Plan outlay was proposed to be cut down by half. But the most remarkable feature of the new Plan was that it was to be a 'rolling' Plan. Every year the Plan outlay was to be readjusted and Plan priorities revised, if necessary, in the light of prevailing economic circumstances. Not only was an Annual Plan to be worked out, but a new Five Year Plan was to be drawn up, starting afresh each year. This was intended to make planning more relevant to the actual problems facing the economy and to keep the Planning Commission constantly alert regarding the impact of Plan outlay on the working of the economy.

The Plan outlays for 1978–79 and 1979-80, amounting respectively to Rs. 11,591 and Rs. 12,176 crores, were financed mainly with domestic resources. Foreign assistance played an even smaller role than was initially envisaged. This was rendered possible by greater buoyancy in the receipts from public borrowing and by exceeding the limits set earlier for deficit financing. Agricultural production suffered a decline in 1979-80, while there was only a 2 per cent increase in industrial production between 1978 and 1980. At 1970–71 prices the net domestic product in 1979–80 was slightly lower than in 1977-78. There was a return of high inflation as the wholesale price index rose by nearly 17.5 per cent between 1978–79 and 1979-80. The trade balance in 1979-80 was heavily in deficit and the country's foreign exchange reserves dwindled by nearly Rs. 56 crores between March 1979 and March 1980, despite an inflow of over Rs. 1100 crores of foreign loans and grants.

In January 1980 the non-Congress coalition government was voted out of power and its short-lived experiment with 'rolling' plans came to an end.

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5. For the period 1974–78 public sector Plan outlay amounted to Rs. 28,991 crores.

The Planning Commission was constituted once again with members sympathetic to the policies of the new Congress government. The Draft Sixth Plan of 1978–83 was abandoned with effect from April 1, 1980. A new Sixth Plan, to be implemented over the years 1980–85, was drawn up, attuned to the objectives of growth, modernisation, self-reliance and social justice. Modernisation was given special stress in this Plan, since during the Janata regime there had been some tendency to belittle technological progress and to give almost exclusive attention to small and village industries and labour-intensive agriculture.

The public sector outlay in the Sixth Plan was to amount to Rs. 97,500 crores in which the investment component was to be Rs. 84,000 crores. Investment in the private sector during 1980–85 was anticipated at Rs. 74,710 crores. (All figures at 1979–80 prices). The inflow of foreign funds was expected to account for a mere 5.7 per cent of total investment, the rest being supported by domestic savings. About 10.2 per cent of the public sector Plan outlay was to be financed by external assistance.

In the Sixth Plan nearly 45.2 per cent of public sector outlay was earmarked for agriculture, irrigation and power development. Industries and minerals (including petroleum) would absorb 22.8 per cent, while transport and communications would account for 15.9 per cent. The remaining portion of the outlay was for education, health, science and technology, water supply and other welfare services. Compared with the allocation of actual public sector outlay on the Plan during 1974–79, the Sixth Plan put greater stress on agriculture and irrigation, mainly on the ground that additional rural employment opportunities could be created at less expense by following this pattern of development. The same argument would justify the slightly higher allocation for village and small industries in the Sixth Plan as compared with the Fifth. It may be noted that the Draft Sixth Plan for 1978–83, abandoned in the second year of its operation, had allocated an even larger proportion of total outlay for the development of small industries.

The Sixth Plan outlay was designed to raise the gross domestic product (at factor cost) by 28.8 per cent in five years, which implies an annual growth rate of about 5.2 per cent. While agricultural output was expected to rise at the rate of 3.83 per cent per annum in terms of gross value added, output in the manufacturing sector was to rise by 6.5 per cent per annum. As a result the relative importance of the agricultural sector in the gross domestic product was to decline from 35.13 per cent in 1979–80 to 32.90 per cent in 1984–85. However, because of its labour-intensive character, agriculture would provide about 46 per cent of employment, while manufacturing would provide about 15 per cent. The corresponding percentages in 1979–80 were 47.7 and 14.6. The Sixth Plan was designed to bring about an expansion in employment opportunities by 3.4 crore person years.[6]

6. One 'standard' person year is equivalent to 273 days with 8 hours of employment on each day.

This was expected to take care of the increment to the working population during 1980–85.

Poverty, in the sense of an inadequate intake of food, was declining very slowly, if at all, though since 1950, after nearly three decades of planned development, per capita income had gone up by nearly 57 per cent by 1978–79.[7] Obviously the distribution of income was not changing in favour of the poor. A slight improvement was, however, noticed when National Sample Survey data brought out that the proportion of population below the 'poverty line' had declined from 51.49 per cent to 48.13 per cent between 1972–73 and 1977–78. The Sixth Plan was drawn up to make the schemes of poverty alleviation even more effective; the goal was set at reducing this proportion to 38.93 per cent by 1984–85. This was to be achieved (*a*) by redistribution of land from people holding more than 5 acres of land to smaller farmers and landless agricultural workers, (*b*) by providing employment to rural workers during the slack agricultural season, as contemplated in the National Rural Employment Programme (NREP), and (*c*) by equipping poor families with income-yielding assets, partly on loan and partly as a bounty, through the Integrated Rural Development Programme (IRDP).

Nearly 89 per cent of the public sector Plan outlay for 1980–85 was expected to be covered by domestic financial resources. Deficit financing was to remain limited to about 5 per cent of outlay. To secure price stability demand management measures were to be supplemented by supply management, particularly through removal of critical bottlenecks on the supply side in the form of shortages of power and transport facilities.

The Sixth Plan took account of the rising prices of imported petroleum and petroleum products and provided additional funds for domestic oil exploration. In spite of this the import bill was expected to grow at 1978–79 prices by nearly 7.9 per cent per annum excluding 'contingency' imports of Rs. 1000 crores. To keep the trade deficit within manageable limits, the rate of growth of exports had to be stepped up in real terms to 9 per cent per annum; the prevailing rate throughout the 'seventies was about 6 per cent. Improvement in earnings from invisibles, aided by withdrawal of Rs. 1000 crores from the foreign exchange reserves, was expected to maintain the country's external accounts in balance, even after allowing for the fact that the terms of trade were expected to turn against the country.

The balance of payments position, however, proved to be more difficult than was expected and India had to draw out foreign exchange from the International Monetary Fund to the extent of Rs. 4750 crores over the Sixth Plan years. Foreign exchange reserves declined in the first two years of the Plan, but rose later. As a proportion of the value of imports, foreign exchange reserves were lower in 1985-86 than in 1980–81.

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7. This implies an average increase of about 1.6 per cent per annum.

The index of agricultural production rose at a slow rate, possibly below 2 per cent per annum, over the years between 1978–79 and 1985–86. Industrial production also rose more slowly than the planned rate; the average growth rate was less than 5 per cent per annum. The national income, however, registered a rate of growth slightly above 5 per cent. This was attributable to the comparatively high rates of expansion in 'tertiary' sectors (professions and services) which contributed in 1984–85 over 40 per cent of the gross domestic product. Inflation proceeded at a rate exceeding 8 per cent per year, as indicated by wholesale prices. Deficit financing had to be relied upon to a much larger extent than was outlined in the Plan; instead of being limited to only 5 per cent of Plan outlay, deficits had financed over 15 per cent.

This was how the economic development plans (the six Five-Year Plans, along with two 'holidays' during 1966–69 and 1978-80) had come to mature in India between 1951 and 1985.

Appendix A
Effects of the Partition (1947) on Indian Economy

The areas in British India, where there was a clear Muslim majority, were conferred separate Statehood by the British Parliament in August 1947. After the transfer of power from Britain to India there were two States in place of one, the Indian Union and Pakistan. To both the States were added the Princely States which opted for inclusion in either the Indian Union or Pakistan. British India had developed as a unit with different regions specialising in different kinds of economic activity and therefore mutually dependent on each other. This economic unity was suddenly swept away and barriers were raised between inter-dependent regions as an outcome of the partition.

The Indian Union had a greater density of population. It had nearly 82 per cent of the population of undivided India with a little more than 77 per cent of the geographical area. But the territory of the Indian Union had a larger sown area per head of population. Moreover, most of the valuable mineral resources were in Indian territory. Pakistan secured only about 3 per cent of the total mineral wealth of undivided India in value terms, its range of mineral resources being limited to some inferior-grade coal, petroleum, salt, gypsum and a few minor ores. The bulk of the hydro-electric potential was also located in the Indian Union, the share of Pakistan being estimated at only about 2 per cent or so of the potential of undivided India. Of the total installed electricity-generating capacity, India obtained nearly 95 per cent.

Although *per capita* sown area was larger in India, Pakistan's share of the irrigated area was larger. Of the 70 million acres of irrigated area in India before partition, Pakistan's share was 22 million acres. While 45.2 per cent of net sown area in Pakistan received irrigation water, in India this percentage was only 18.9. The irrigation works that were situated in Pakistan were more extensive and contributed more to agricultural yields than those situated in India. As a result, the partition endowed Pakistan with a food surplus, while the Indian Union was in a greater state of deficit in food than was undivided India. Some of the best cotton- and jute-producing areas of undivided India were also included in Pakistan, cotton in Sind and Western Punjab and jute in Eastern Bengal. Since most of the cotton mills and all jute mills were located on Indian Union territory,

a tremendous problem arose in keeping the mills supplied with raw materials. Not more than 65 per cent of the Indian mills' requirements of raw cotton could be met from the indigenous crop. In raw jute India was even more deficient; only about 19 per cent of the requirements of the jute mills could be met from domestic sources. Immediately after partition political relations between India and Pakistan were so strained that obtaining these raw materials by import from Pakistan became fraught with great uncertainty and involved high cost. Special measures were adopted in India to augment domestic supplies of cotton and jute, sometimes even at the expense of food production. Thus the food deficit in India was aggravated, while attempts to grow jute and cotton in relatively unfavourable conditions pushed up the cost of cultivation of these crops. This led to increases in prices of industrial products using these raw materials.

The regions comprising the State of Pakistan were industrially less developed than the regions incorporated in India.[1] Judging by the share of the industrial labour force in 1947, Pakistan accounted for only 8.8 per cent of the total number of industrial workers in undivided India. However, the barriers that now came to be erected between Pakistan and India harmed both the raw material producers in Pakistan and the industrial establishments in India. If trade had not been restricted (often on political grounds) and transport remained uneffected by the upheaval accompanying the partition, a smooth flow of raw materials to industrial centres could be maintained. But the transition to the new situation was much less smooth. As a result India had to look for raw material supplies to other and more expensive sources and Pakistan had to import her requirements of manufactured goods from countries other than India. Quite a number of Indian industries found that after partition their domestic markets had shrunk and, what was more to the point, exports to Pakistan markets were made difficult by innumerable regulations. Besides, industrial units located near the border between the two States sometimes felt so insecure that they had to shift to areas farther away in the interior. Problems were also created in those cases where the majority of workers in an occupation belonged to a community that considered itself insecure in the new State. Their migration to the other State meant a loss of skilled and experienced workers which had to be made good by training up a new band of workers. Some dislocation in industrial production in India became unavoidable as a result, even though the Indian Union secured the bulk of the industrial assets.

The character of foreign trade underwent a profound change in the years following the partition. Undivided India had surpluses in raw cotton,

1. At the time of partition India had 422 cotton mills. Only 14 of them were located in Pakistan territory. The number of industrial establishments in Pakistan was only 1,213 and only 2.5 lakh workers were employed in such establishments. In the Indian Union there were 10,881 establishments employing 25.8 lakh workers. See Ghosh, B.B., *Indian Economics and Pakistani Economics*, p. 263.

raw jute, hides and skins and several other raw produce which were exported. After partition the Indian Union had to obtain such raw products by import, because the exportable surpluses of earlier years originated in areas now forming part of Pakistan. The Indian Union became a raw material-importing country, unlike India before partition which was an exporter of raw materials. Even industrial exports were hard to build up in India where raw materials were either in short supply or had to be secured at heavy expense from other parts of the world. At this time India was suffering from a food shortage as well. Industries in India required larger imports of machinery to replace equipment that had fallen into disrepair during World War II. A huge gap, therefore, arose between imports and exports which drove India to increase external borrowing as well as to devalue the rupee in 1949 and 1966.

Railway rolling-stock was divided between India and Pakistan on the basis of railway mileage and volume of traffic. So far as mileage was concerned, the Indian Union accounted for nearly 80 per cent of the tracks. But some of these tracks had to be re-laid after partition. Some problem was caused by the fact that new railway workshops had to be set up for those railways which were previously served by workshops located in areas now included in the other State. This problem affected primarily the Northern Railways. Again, railways had to suffer due to migration of staff in those cases where the occupational categories of out-migrants and in-migrants did not match. In some parts of India (e.g., West Bengal) the borders after the partition were drawn in such a manner that part of the railway track became included in Pakistan and therefore an alternative route had to be built. The loss of Karachi port in Sind compelled India to develop new port facilities at Kandla. New railway links had to be provided for transport of cargo to this port.

Government property comprising both real and financial assets had to be divided up between the two States. For the division of real assets a Committee consisting of representatives of both States was set up. So far as financial assets were concerned, a division of the foreign exchange (sterling) assets was effected. In respect of financial liabilities it was agreed that the Indian Union would assume the entire burden. but the stipulation was made that Pakistan would remain liable to India for repayment of Rs. 300 crores, which was to be recovered along with interest in equal annual instalments over a 50 year period starting from 1952. This amount is still shown as a recoverable debt in Indian government accounts. but the probability of recovery is certainly very small.[2]

2. Some other effects of the partition may be briefly noted. The unified system of banking and financial institutions built up over a period of nearly 100 years was dealt a severe blow. Many such institutions found themselves with frozen assets. Others had to reorganise their administrative structure. The territory included in Pakistan accounted for nearly 20 per cent of bank offices in undivided India.

Finally, the partition created the problem of refugee re-settlement in both the States. It is estimated that nearly 87 lakh people were uprooted from their hearth and home in the wake of the partition. This does not take account of many thousands who were killed in communal riots that flared up in many parts of the country or who died on their way to the State of their choice. Many of these refugees left valuable property at home and had to be rehabilitated from the miserable condition to which they had sunk in the aftermath of the partition. The cost of giving temporary shelter to this refugee population and subsequently of helping them with loans to build houses and setting up new business units proved to be quite substantial. This caused a diversion of funds from development work and delayed the attainment of targets in respect of various economic and social services that were so essential for national well-being.

Appendix B

The Rupee-Sterling Exchange, 1893-98*

By passing the Coinage Act of June 26, 1893 the Government of India closed the mints to free coinage of silver. The Government, however, retained the power to coin silver on its own account. Three administrative notifications were issued. The first provided for giving silver rupees in exchange for gold presented at the Indian mints at the rate of 16d. per rupee. The second provided that sovereigns and half-sovereigns would be received by the government in payment of taxes and other government dues at the same rate. The third was regarding the issue of currency notes in exchange for British coin or gold bullion at the rate of 16d. to the rupee.

For various reasons these provisions which marked the severance of India from the silver standard are very important. Henceforth silver lost one of its strongholds. This marked the recognition of the fact that the days of bimetallism and of silver standards were gone. As a matter of fact this plan was adopted by India only after the failure of the Monetary Conferences of 1892 to arrive at any agreement regarding the future of silver. Above all, this meant for India the first step in the inauguration of a system which has been the focus of so much praise and so much abuse—the celebrated gold exchange standard which may be said to be India's contribution to the world's currency systems.

Why did India have to take this step? To understand this we have to study the history of silver prices before 1893. In 1872–73 the average price of silver bar per oz. was $60\frac{5}{16}$d; by 1892–93 it had fallen to the low level of $39\frac{1}{16}$d. per oz. It is a known fact that exchange between a gold standard and a silver standard country depends on the prices of silver and gold. If silver is falling in value in terms of gold, the exchange of the silver standard country depreciates. The reverse happens if the price of silver rises. Thus from 1872–73 Indian exchange fell and the fall in the exchange kept pace with the fall in the value of silver. In 1872–73 the exchange was 1s.10.754d. to the rupee; in 1892–93 it was 1s.2.984d. to the rupee (see Table B.1)

Before examining the effects of this exchange depreciation on India, it will be interesting to see what caused this fall in the price of silver. If the causes are found to be of such a nature as would warrant a belief that the fall in the price of silver was going to be a permanent phenomenon, then

*Contributed by J. Banerjea.

Table B.1
Relation between gold price of silver and Rupee-sterling exchange

Year	Av. price of Silver bar per oz (Pixley and Abell)	Average rate of exchange s.	d. per rupee
1872–73	60 5/16	1	10.754
1873–74	59 1/4	1	10.351
1874–75	58 5/16	1	10.221
1875–76	56 7/8	1	9.645
1876–77	52 3/4	1	8.491
1877–78	54 13/16	1	8 790
1878–79	52 9/16	1	7.761
1879–80	51 1/4	1	7.961
1880–81	52 1/4	1	7.956
1881–82	51 11/16	1	7.895
1882–83	51 5/8	1	7.525
1883–84	50 9/16	1	7.536
1884–85	50 5/8	1	7.308
1885–86	48 5/8	1	6.254
1886–87	45 3/8	1	5.441
1887–88	44 5/8	1	4.899
1888–89	42 7/8	1	4.379
1889–90	42 11/16	1	4.566
1890–91	47 11/16	1	6 089
1891–92	45 1/16	1	4.733
1892–93	39 1/16	1	2.984

Average price of bar silver taken from *Report of Fowler Committee*. Appendix No. 12, p. 144. Average rate of exchange taken from *Index No. of Indian Prices* 1821–1926, p. 18.

we will be able to appreciate the anxiety of the Government of India to give up the silver standard and adopt the gold standard.

In the twenties of the nineteenth century England was practically the only country on the gold standard. After a period of inconvertibility lasting from 1797 to 1820, the Bank of England resumed redemption of its notes in gold coin after May 1, 1821. By 1873, when the Latin Monetary union was dissolved almost all the important countries came to be on the gold standard. The motives and factors which led to the adoption of gold as the monetary standard and to the demonetisation of silver by these countries cannot be dealt with here. National pride, growing appreciation of gold as the more convenient metal for countries with growing wealth due to its higher unit value, inconvenience caused by constant variations in the ratio between gold and silver—these were some of the causes leading to the regime of international gold standard.

The demonetisation of silver naturally meant a lessened demand for it; there was also some sale of demonetised silver, particularly by Germany, but this was stopped in 1879 and was not of very great importance. At the

same time the production of silver was increasing. In 1888 it was reported that silver "has increased nearly 50% during the last quinquennial periods".* It is the law of supply and demand that price falls if demand does not increase, while supply increases. In the case of silver there was no chance of any permanent increase in its demand unless it was restored to its earlier status as a monetary unit. Hence the efforts of the Indian Government to introduce international bimetallism. The failure of the Brussels Monetary Conference in 1892 finally extinguished hopes in this direction.

From the side of gold. too causes had been operating which tended to reduce the gold value of silver. There were several factors which tended to keep up the value of gold. The demand for gold was increasing because of gradual adoption of the gold standard by one country after another in the Western hemisphere. Again the fall in [general] prices in terms of gold during this period suggests that the supply of gold was not quite adequate to meet the ever increasing demand for gold.

It has, indeed, been suggested that the fall in the price of silver was more a manifestation [an expression] of the appreciation of gold than a depreciation of silver. The value of both gold and silver is best expressed by their purchasing power over commodities in general. This test lends direct support to the above view.

The statistical evidence makes appreciation of gold primarily responsible for the decline in the price of silver. There is no doubt that gold did appreciate during this period in terms of commodities in general, but the appreciation of gold does not offer as witness the fall of prices. This may not, however, be a totally satisfactory explanation of the fall in the price of silver. For, if depreciation of silver was simply due to appreciation of gold, one would expect this depreciation to disappear when gold ceased to appreciate and depreciation of gold in the shape of rising prices took place. There was, in fact, no shortage of gold after the South African mines began to unload their output. Yet the price of silver did not recover permanently. It is true that after the First World War silver experienced a spectacular rise in price but that was a temporary phenomenon due to exceptional circumstances engendered by the war.

The prospect before the monetary authorities in India was indeed very gloomy. When we consider the bad effects of this fall in the price of silver manifesting itself through a continuously falling exchange with the gold standard countries, their anxiety to give up the relationship with silver becomes understandable. The Finance Members of the Government of India were directly concerned with the problem because of the havoc depreciating exchange did to the budget. Every year the Government of India had to remit large sums to England as payment under various headings, e.g.

*Royal Commission on Gold and Silver, Final Report, p. 22 Reprint, Columbia University Press 1936.

services, interest on government debt etc. These were known as Home charges and they used to be made on a gold basis and most of them were comparatively fixed. The money had to be raised through taxes in India and then remitted to England. Thus, if in any year the Home charges amounted to £1000 and the rate of exchange was 2s. per rupee (£1=R 10), Rs. 10,000 would have to be raised in India to pay this debt. But if the exchange was 1s. 4d. per rupee (£1=R 15), Rs. 15,000 would be required to pay the same debt. This naturally was the point made most prominent in the despatches from the Government of India to the British Government.

The Herschell Committee which was appointed in October 1892 to enquire into the currency situation in India also pointed out the financial burdens and inconveniences imposed upon the Indian Government due to the above circumstances. Some facts given by the Herschell Committee would be interesting in this connection. From 1872-73 to 1892-93 the net annual disbursements of the Indian Government in England (*e.g.* payments for the discharge of debts and all capital transactions) varied between £13.3 million and £16.8 million. The total of these Home charges for 1892 was computed at £16 million. The gold value of the rupee as measured by the average exchange rate in London on India for the fiscal year 1872-73 was 22.75d which meant that it cost India approximately Rs. 10.55 to lay down one pound sterling in London; but in 1892-93 when the average sterling value of the rupee was 14.98d, it cost India Rs. 16.02 to lay down the same amount in London—an increase of 52% in twenty years.*

The Herschell Committee also considered the effects of the system on the people of India and on the European officials.** As regards the effect on the people of India, the Committee pointed out that the fall penalised certain sections of the community. Those paying fixed land revenue under the permanent settlement did not suffer; the increased salt tax to meet the increasing Home Charges pressed upon the people at large. The falling exchange rate was of some benefit to the exporters, no doubt; but in so far as they had to buy imported goods at increasing prices this gain tended to disappear and it may be said that at this time many necessary articles like cotton goods were imported to a very large extent.

Against this doubtful gain to a particular section, we must place the fact that the falling exchange made machinery for industrial development, railways and other similar imports more costly and to that extent tended to retard the development of the country. The votaries of to the silver standard pointed out that gold prices were declining and, therefore, India was most probably receiving as much of these goods as it had done before. But, it may be said that had the exchanges not been falling India would have got even more of these imports than she was already receiving.

*Herschell Committee Report, para. 5, also Sir David Barbour quoted by Wadia & Joshi, p. 293, Vol. 2.

**Herschell Committee Report, paras. 3–6 & 32–34.

Even the exporters could not have gained very much from the depreciating exchange because India at this period was almost solely an exporter of goods whose demand was more or less inelastic—wheat, rice or jute. Their consumption could not have increased much with a lowered price. Accordingly, balancing the gain and loss to the Indian people as a whole, one is bound to come to the conclusion that the losses outweighed the gains.

Apart from increased tax burden and increased prices of imported goods, there was another way in which the depreciating exchange was harmful to the interests of the Indian people. In India the task of providing the country with the two prime requisites of a sustained economic life—a system of transport and a network of irrigation—had fallen upon the country's government. For providing these requisites of development the government had undertaken a policy of "Extraordinary Public Works". The necessary capital was not forthcoming in India and recourse, therefore, had to be had to foreign financial markets which meant at this time London.* With falling exchange the English investors became increasingly unwilling to buy rupee securities and began to insist on sterling securities. Borrowing on sterling securities meant increasing gold payments and the government was unwilling to do anything which increased their gold commitments. The change in the character of Indian debt in London—the distribution between rupee and sterling securities—is evident from the following table.**

Table B.2

	Sterling debt (in Rs.)	*Rupee debt (in Rs.)*
End of 1873–74	41,117,617	66,41,72,900
End of 1898–99	124,268,605	1,12,65,04,340

Further import of capital on private account was also necessary for India's economic well-being. The Report of the Famine Commission of 1880 advocated diversification of industries as an avenue of escape from the ravages of famine. The private English investor was apt to look upon the investment of capital in India as a risky proposition. It was feared that once the capital was spread out in a silver country every fall in the price of silver would not only make the return uncertain when drawn in gold, but

*There was nothing wrong or injurious to Indian interests in borrowing money in London so long as the rate of interest paid was not too high. Almost all the countries, including the United States, used to raise capital in London to carry out internal development.

**See Appendix II, p. 179 of the Indian Currency Committee of 1898.

would also reduce the capital value of his investment in terms of gold which was naturally the unit in which he measured all his returns and outlays. Thus India's development was at stake.*

According to Gresham's law bad money drives out good money. Silver was thus driving gold out of India since India was still one of the few countries on silver standard and hence received silver more and more. But the more silver she received the more difficult it became for India to disgorge her silver in future for this would lead to a drastic fall in the price of the white metal and instead of holding an appreciating asset, India was now holding a depreciating asset. This, again, was an argument against continued adherence to the silver standard.

In this formidable list of the disadvantages accruing from the falling price of silver, one must also include the difficulties of the European officials who had to remit given amounts, in terms of sterling to England for the support of their families and the education of their children.

It thus became apparent, that continuing the relationship with silver was fraught with many disadvantages and difficulties and, if one took into consideration the future of the price of silver, was bound to do unlimited damage to the Indian economy. The only course open before the government was to sever the connection of the rupee with silver and the Herschell Committee recommended this step. The committee accepted the plan of the Indian government for the closing of the mint to the free coinage of silver and for the ultimate adoption of the gold standard, with two modifications. The closing of the mints to the free coinage of silver was to be accompanied by an announcement that though closed to the public, the mints would be used by the government for the coinage of rupees in exchange for gold at the rate of 16d. per rupee. The rate was not thought by the committee as necessarily a permanent one. Many expected that the rate might go up all on a sudden. It was to avoid such a contingency, to prevent the currency supply from being entirely unautomatic and to lighten the blow which the closing of the mints to free coinage would give the price of silver that the committee recommended this modification. Secondly, gold was to be received at the government treasuries in payment of public dues at the same rate. Both these recommendations were designed to pave the way to the linking of the rupee with gold.

It was hoped that by closing the mints to the free coinage of silver, the exchange value of the rupee could at once be divorced from its bullion value which was declining almost continuously. The intention was not to raise the gold value of the rupee, but to prevent it from declining further and ultimately to stabilise it. The rate of 1s. 4d. which was fixed upon for this was the average rate for approximately the preceding two years. From

*Ambedkar—Problem of the Rupee, pp. 91 & 96.

July 1891 to June 1893 the sterling value of the rupee had ranged from $17\frac{3}{4}$d. to $14\frac{5}{16}$d, the mean being exactly 16d. The average monthly rates of exchange for "council bills" from June 1891 to May 1893 inclusive was $15\frac{23}{32}$d. and the average for the two and a half year period, December 1890 to May 1893, was $16\frac{3}{32}$d. Thus the rate of 16d. seemed a fairly representative one. Another appeal of the 16d. rate was the ease with which this rate assimilated the Indian Currency units.*

Immediately following the closing of the mints the exchange rose and this rise itself tended to confirm the belief of those who expected the immediate attainment of a 16d. rate. Even the Indian Government became convinced of the soundness of this belief and apparently expecting the attainment of the new gold par within a few months urged the Secretary of State for India not to sell council bills below a 16d. basis. But the sharp rise was due to a heavy speculation in rupee paper which began as soon as it was known that the mints would be closed and that the gold value of the rupee was to be raised to a maximum of 16d. The very expectation of the rise caused the rise. However, the rupee after its sharp rise following the closing of the mints fell away and the Secretary of State could not sell council bills at 16d. In the end the attempt was abandoned on January 20, 1894.

The immediate failure of the policy of 1893 was due to a variety of reasons, some beyond the control of the Government of India. The Baring Crisis of 1890 had initiated a depression and the period 1891–94 was one of trade depression and bad harvests throughout Europe. In 1893 there was a monetary panic in U.S.A. Under these circumstances the success of any currency reform would have been doubtful. It is noteworthy that both Austria and Russia also introduced currency reforms about the same time and that there also the reforms were really effective only when trade conditions stabilised. Further the scheme was introduced at a very unfavourable time of the year. The latter half of the year is usually a slack season when exports are usually low and the balance of trade is against India. If one thing was absolutely necessary to keep up the exchange value of the rupee, it was a favourable balance of trade; for that would mean a demand for rupees and rupee exchange would be strong. The ease with which the 1s.4d. rate was maintained after 1898 was due to large favourable balances of trade. When in 1907–8 the trade balance was against India, the exchange became weak and the weakness was not rectified till the Government came to the rescue and declared that it would sell sterling to anybody in India wanting it. In 1893 the Government had not the mechanism to keep exchange steady; they had thought that mere divorce from silver would be enough to keep up the exchange.

*£1 = R 15 — 1 as = 1d
R 1 = 16 as — 1 as = 4 pice
1 pice = 1 farthing

The course of the exchange during the subsequent period has been thus expressed by Kemmerer. He observed that "although during this period the exchange value of the rupee was always far above the bullion value, and the difference tended to be a widening one, there was still a remarkable parallelism in the movements of the two curves of the foreign exchange and the bullion value of the rupee.* Exchange was at its lowest point in 1894; thenceforward it began to rise slowly till in 1898 it reached the gold point. In 1898 it became for the first time profitable for persons out of India who had payments to make in India to take advantage of the standing offer of the Government of India to give rupees at the Calcutta or Bombay mints or issue notes at the paper currency offices, against gold tendered to them at a rate of exchange equivalent to 15 rupees to £1. In short the exchange value of the rupee had then risen to 1s.4d.

	Intrinsic value of Rs. as silver bullion	*Average exchange value*
1894	11 1/5d	1s 1 1/2 d
1895	11 3/8 d	1s 1 3/8 d
1896	11 7/8 d	1s 2 1/2 d
1897	10 1/2 d	1s 3 1/4 d
1898	10 3/8 d	1s 3 7/8 d

There have been various criticisms of the policy followed during these years. Some critics have argued that a policy was followed of raising the exchange value of the rupee by contracting the supply of currency; the contraction followed automatically from a cessation of further coinage and issuance of currency of any form because expanding trade and expanding population require larger amounts of money. If hand to hand currency is not available the use of deposit currency through cheques may fill the gap. This was the case in England where deposit currency very soon came to be the main media of payment after the middle of the 19th century. In a country like India, where even now the use of cheques is at a very low level, conditions in the period under consideration may be easily imagined. In the absence of adequate banking facilities and prevalence of the habit of cash payments, growing trade, production and population demanded more currency. This, however, was not forthcoming. The consequence was a fall in prices, stringency in the money market, and difficulties faced by exporters because of appreciating exchange.

Before discussing whether these strictures are true or not, it would be interesting to see how much currency contraction there was in fact. There is no evidence of an absolute contraction of currency. But the argument

*Chamberlain Commission Report, Sec. 14.

that there was a relative contraction of currency has a stronger case. Indeed the essence of the plan as formulated by the Government of India and the Herschell Committee was to divorce the value of the rupee from its silver content and to prevent its further depreciation. It was regarded quite possible, on the basis of the Quantity Theory of Money, "to reduce the amount of the rupee circulation to such an extent as to bring the Indian exchange into par with gold at a rate of exchange which could be permanently maintained".

It seems fair to point out at this stage that in those days stability of exchange was regarded as a thing of supreme importance. The idea that it is better to have a flexible exchange rather than to have stable exchange and disturb internal cost and income structure was in those days practically unknown.

The whole world was rapidly becoming an interconnected and organic whole. As international trade and commerce developed, the price levels and the cost and income structures of the different countries were becoming more and more dependent on those of the others. Any disturbance in the credit and business conditions of one country was making its influence felt in other countries. This integrated system was regarded as good and people wanted to keep in step with other countries. A stable exchange was essential for this. Therefore it will not be fair to blame the officials of the Government of India if they tried to reach a stable exchange and were rather insensitive to hardships it might cause to some. The valid criticism would be that they tried to fix the exchange at too high a level and thereby caused unnecessary difficulties. But here again we can not blame the Government or the Herschell Committee for deciding on the 1s.4d. ratio. The average rate ranged round 16½d. in 1887 88, 1888–89, 1889–90, and again in 1891–92; in 1892–93 the average rate had fallen to under 15d. The rate of 1s.4d. was provisional and the rise of the exchange before and after the closing of the mints to free coinage of silver confused the officials.

It is true that after this short rise, the exchange fell away till on 23rd January, 1895 council bills were sold at 1s.$\frac{13}{32}$d. But it must be remembered that the price of silver fell to a greater extent during these years following the repeal of the Sherman Act in the United States and the closing of the Indian mints, that naturally the rupee tended to move down in the absence of any support, and that these were years of depression abroad which meant less demand for Indian products. The declining price of silver made it profitable to send silver in large quantities to India in payment for her exports. Silver thus performed the function of breaking the attempt of the Secretary of State for India to establish a quasi-monopoly price on remittances to India. The criticism that high exchange hampered export trade does not apply till after January 1895 from when the exchange began to rise. Exchange began to rise from January 1895 and it reached gold

import point in 1898. It was during this period, therefore, that exporters could have suffered. It will be interesting to examine the figures for exports during these years. Gross exports in 1895–96 amounted to Rs. 114,265,000. They fell to Rs. 103,914,000 in 1896–97 and in 1897–98 reached the low level of Rs. 97,537,000. This, however, proves nothing; for these were famine years. Further, while exchange was reaching the gold point in 1898 exports were increasing and during 1898–99 reached the figure of Rs. 112,723,000. (See Table B.3).

Table B. 3
Movement of Rupee-Sterling exchange, 1887–1899

	Exchange (*d.*)	*Silver, per oz* (*d.*)	*Exports of merchandise* (*Rs.* 000)
1887–88	16.898	44 5/8	90,471
1888–89	16.379	42 7/8	96,978
1889–90	16.566	42 11/16	103,397
1890–91	18.089	47 11/16	100,136
1891–92	16.733	45 1/16	108,036
1892–93	14.985	39 13/16	106,536
1893–94	15.547	35 5/16	106,448
1894–95	13.101	28 5/16	108,815
1895–96	13.638	29 7/8	114,263
*1896–97	14.451	30 3/4	103,914
*1897–98	15.354	27 9/16	97,537
1898–99	15.978	26 15/16	112,723

*Famine years

Again from the point of view of benefit to Indians the case against the Government falls flat. Whatever the benefits from a falling exchange, they are only temporary and once the exchange is stabilised, they vanish. One section of the community makes a gain at the expense of others. The Government of India in a letter to the Honorary Secretary of the Darjeeling Tea Planters' Association, dated 12th October 1892, expressed this view very clearly. It said that the producer of an article of export may make a temporary and unfair gain from depreciation of the standard at the expense of his employees and of other persons to whom he makes fixed payment.*

As regards decline in general prices, it does not seem that there was a very large decline. This is evident from the index numbers of prices in India compiled by the Department of Commercial Intelligence and statistics. This is a weighted index number of 100 articles equated to 100 for 1873. It is to be noted that 1896 and 1897 were years of famine.

*Fowler Committee Report 1898.

Table B.4
Index numbers of prices, 1893-1900
(1873 = 100)

1893	129
1894	122
1895	120
1896	131
1897	154
1898	125
1899	121
1900	143

Bank rates in India were high in 1896 and 1897 and in February 1898 rose to 12%. The high rates during these years are attributable to famine conditions. According to the Fowler Committee the Government of India used to place large sums at the disposal of the money market every year through sales of council bills. In 1897, owing to the depletion of the balances brought about by expenditure on famine relief, military operations and falling revenue the Secretary of State could place only a very small sum at the disposal of the money market as compared to the previous years.*

The critics who attribute falling prices and high bank rates solely to the exchange policy of the Government miss the real issue. There was no doubt that there was some stringency of currency in India from 1896. The causes, however, were different. Lindsay observed that in 1895–96 there was an extension of joint-stock enterprise in the shape of the development of jute mills and indigo mills and an increase of commercial enterprise generally. There was also an increased demand for money owing to the large export demand for wheat and seeds and for the financing of high priced foodcrops. It is this explanation of the relative contraction of currency which deserves to be considered.** For the growth of the commercial and industrial demands for currency, which caused the monetary stringency, indicated the beginning of a movement which was destined to have a highly favourable effect upon the Indian exchange. The trade depression abroad was over; there was growing demand for Indian products which led to a revival of trade and industry in India. There were highly favourable balances of trade and it is this which was really responsible for both the rise in the exchange and the monetary stringency. They were both the results of one and the same cause—trade revival and the consequent favourable balance of trade. In 1898 it seemed that the period of groping was over; the rupee had reached 1s.4d. and everywhere there was a growing clamour for a fixed policy. The time had come when an end should be put to an anomalous situation

*Fowler Committee Report, Sec. 22.
**Coyajee, J.C.,– Indian Currency System, p. 106.

in which rupee was neither on silver standard, nor on gold standard; when the rupee was being allowed to find its own level, if one may say so.

It was under these circumstances that the Fowler Committee was appointed to consider the proposals of the Government of India and also any other matter which they might think relevant including the monetary system then in force. They were asked to enquire into the probable effects of any proposed changes upon internal trade and taxation. The Committee was to draw up any modifications of the proposals of the Indian Government or any suggestions of their own which they might think advisable for the establishment of a satisfactory system of currency in India and for securing as far as is practicable a stable exchange between India and the United Kingdom.

Appendix C

The Rupee-Sterling Exchange, 1927-31*

The exchange ratio has always been the subject of immense controversy in India. This was particularly true in the years after the First World War and specially after the stabilisation of the rupee at 1s.6d. in 1927. There was yet another controversy when the rupee was linked to sterling in September 1931 after the abandonment of the gold standard by England. The opponents of the 1s. 6d. ratio have mainly advocated a 1s.4d. ratio and their main argument has always been that the latter ratio is "natural", though they have never taken much pains to explain what they mean.

It is admitted that lowering of the rate of exchange from 1s.6d. to 1s.4d. would benefit the exporters, but for only that period of time during which the process of adjustment would be taking place. The question was whether the benefit would last for long, or whether the economy will soon adjust itself to the new rate.

Let us now see what are the facts in our case. In 1920 the government decided to fix the exchange at 2s. gold but had to give up the attempt and adopted the policy of letting the exchange find its own level. By 1922 exchange had fallen to a low level of 1s.2⅞d. but immediately after a recovery set in due to various causes and exchange began to improve. By 1924 it had reached a level of 1s. 6d. and henceforth the policy of the Government was to see that it did not exceed this limit. Throughout the next few years the rate fluctuated around this level and it does not appear as if the government had any difficulty in keeping the rate at this level.

The argument of the advocates of the 1s. 4d rate that this was the rate at which contracts were entered into because of the expectation that ultimately this rate would be restored can be disposed of at once. This rate was non-existent since 1916 and it is highly improbable that people could have made contracts at this rate amidst the fluctuations of the postwar years. On the other hand, the presumption is that people had entered into contracts, at least during the period since 1924, bearing in mind the 1s.6d. rate, as it was evident that the government would finally want to have the exchange at that very level.

As regards adjustment to either the 1s.4d. or the 1s.6d., one law only points out that statistical proof, particularly in calculations of the proper rates of exchange, is not to be taken too seriously. In India the difficulty

*Contributed by J. Banerjea.

is enhanced because of a lack of adequate statistics. The index of the whole-sale prices published by the Government was admitted even by the authorities to be unsatisfactory. There was no satisfactory cost of living index for the whole country, simply for the reason that because of diversity of conditions obtaining in the different parts, it was not possible to construct such an index for the whole country which would still be of some significance. The majority report of the Royal Commission of 1926 applied the tests of economic science to see if there was a substantial measure of adjustment to the prevailing rate and were satisfied that there was. On the other hand, the minority Report produced data to prove that at 1s. 6d. there would be imposed on the Indian economy a considerable strain and that 1s.4d. was the proper rate.

The question boiled down to this: at which rate of exchange the strain on the economy would be the least? Prima facie, the case was in favour of 1s. 6d and against 1s. 4d. Since 1916 the latter rate was not a practical factor in the situation. During the upward movement of the rupee this rate was reached and passed. But since 1924 the de facto rate had been 18d. It was to be expected that a considerable measure of adjustment had been attained at this rate and to go back to 1s.4d. would have meant that all this would be undone and a fresh start made.

One may certainly criticise the policy which waited till the exchange reached 1s.6d. and then decided to fix the rate at that level. It may be asked why did the authorities not try to keep the exchange at 1s.4d. when that rate was reached and there was a tendency for the rate to go up. Why this partiality in favour of the 1s.6d. ratio? The government never gave a satisfactory explanation of this policy. It is very difficult to see why the government did not try to fix the exchange at 1s. 4d. when it was first reached in December 1922. This policy would have meant that the amount of currency in circulation in the end would be somewhat higher, the price level a bit higher than it was, but in the long run there would be no gain or loss to anybody.

Another criticism which can be made is that just as the pound was then over-valued in terms of the dollar, at the rate of 1s. 6d. the rupee would also be over-valued in relation to the dollar. A lower rate would have rectified this defect.

The supporters of the 1s. 4d. rate can point to the loose grip of the rupee on the 1s. 6d. rate for three or four years after its introduction in 1927. The exchange was weak in 1927 and in 1928 and again in the early part of 1929. The position of the Government was rather difficult because of its annual sterling obligations. It had two alternatives—ship gold or deflate. It chose the latter and raised the rate of interest at which it was prepared to give emergency currency up to 12 crores to the Imperial Bank from 7 to 8 per cent as from 14th February 1930.* Already in 1927 it had raised the rate from 6

*Controller of Currency Report 1930-31.

to 7 per cent. This fact had led the Bankers' Magazine to remark that it would seem that this had been done as part of the measures to sustain the rupee at 1s. 6d. for the rate had been showing signs of weakness latterly.* Exchange was weak again for the greater part of 1930-31. A period of consistent weakness set in from the middle of November 1930 and it lasted until the end of February 1931. Rumours that recommendation would be made to the Round Table Conference about to meet in London that a reversion should be made to 16d. rate made the market speculative and sterling to the extent of £5,650,000 was sold between November 1930 and March 1931. The Government tried to remedy the situation by deliberate contraction of currency. During the quinquennium 1930-35 no less than Rs. 102.50 crores of note currency was contracted.

The position of the Government was made clear in a statement made by the Secretary of State for India before the House of Commons in England on February 11, 1931. "The Government will use all the means in its power", he asserted, "to maintain the rate in accordance with their statutory obligations". This policy, with all its deficiencies and ill effects, was allowed to rule till the end of the British Raj in India.

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Chapter 4

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